

Cornerstone OnDemand Inc  
Form 10-Q  
November 03, 2016

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 September 30, 2016  
OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number 001-35098

Cornerstone OnDemand, Inc.  
(Exact name of registrant as specified in its charter)  
Delaware 13-4068197  
(State or other jurisdiction of (IRS Employer  
incorporation or organization) Identification No.)  
1601 Cloverfield Blvd.  
Suite 620 South  
Santa Monica, CA 90404  
(Address of principal executive offices, including zip code)  
Registrant's telephone number, including area code:  
(310) 752-0200

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date

Class Outstanding as of October 31, 2016  
Common Stock 56,186,698

CORNERSTONE ONDEMAND, INC.  
 QUARTERLY REPORT ON FORM 10-Q  
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## PART I. FINANCIAL INFORMATION

## ITEM 1. Condensed Consolidated Financial Statements

CORNERSTONE ONDEMAND, INC.  
 CONDENSED CONSOLIDATED BALANCE SHEETS  
 (in thousands, except par values)  
 (unaudited)

|  | September 30,<br>2016 | December 31,<br>2015 |
|--|-----------------------|----------------------|
| Assets   |                       |                      |
| Cash and cash equivalents  | \$ 65,290             | \$ 107,691           |
| Short-term investments   | 172,015               | 136,841              |
| Accounts receivable, net   | 99,581                | 104,686              |
| Deferred commissions   | 32,642                | 35,910               |
| Prepaid expenses and other current assets  | 18,995                | 15,297               |
| Total current assets   | 388,523               | 400,425              |
| Capitalized software development costs, net  | 28,796                | 23,089               |
| Property and equipment, net  | 24,790                | 27,021               |
| Long-term investments  | 73,716                | 64,247               |
| Intangible assets, net   | 9,638                 | 16,713               |
| Goodwill   | 25,894                | 25,894               |
| Other assets, net  | 482                   | 878                  |
| Total Assets   | \$ 551,839            | \$ 558,267           |
| Liabilities and Stockholders' Equity   |                       |                      |
| Liabilities:   |                       |                      |
| Accounts payable   | \$ 13,982             | \$ 18,954            |
| Accrued expenses   | 40,408                | 44,111               |
| Deferred revenue, current portion  | 225,827               | 237,679              |
| Capital lease obligations, current portion   | —                     | 33                   |
| Other liabilities  | 1,359                 | 2,663                |
| Total current liabilities  | 281,576               | 303,440              |
| Convertible notes, net   | 236,110               | 229,305              |
| Other liabilities, non-current   | 2,154                 | 3,240                |
| Deferred revenue, net of current portion   | 9,240                 | 14,460               |
| Total liabilities  | 529,080               | 550,445              |
| Commitments and contingencies (Note 9)   |                       |                      |
| Stockholders' Equity:  |                       |                      |
| Common stock, \$0.0001 par value; 1,000,000 shares authorized, 56,126 and 54,704 shares issued and outstanding at September 30, 2016 and December 31, 2015, respectively | 6                     | 5                    |
| Additional paid-in capital   | 454,399               | 394,089              |
| Accumulated deficit  | (435,101)             | (386,882)            |
| Accumulated other comprehensive income   | 3,455                 | 610                  |
| Total stockholders' equity   | 22,759                | 7,822                |
| Total Liabilities and Stockholders' Equity   | \$ 551,839            | \$ 558,267           |

See accompanying notes to unaudited condensed consolidated financial statements.

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CORNERSTONE ONDEMAND, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
 (in thousands, except per share data)  
 (unaudited)

|   | Three Months Ended |             | Nine Months Ended |             |
|---|--------------------|-------------|-------------------|-------------|
|   | September 30,      |             | September 30,     |             |
|   | 2016               | 2015        | 2016              | 2015        |
| Revenue   | \$107,758          | \$87,271    | \$314,095         | \$243,789   |
| Cost of revenue   | 33,369             | 27,246      | 100,974           | 79,801      |
| Gross profit  | 74,389             | 60,025      | 213,121           | 163,988     |
| Operating expenses:   |                    |             |                   |             |
| Sales and marketing   | 53,690             | 53,255      | 168,226           | 150,659     |
| Research and development                                      | 12,130             | 10,457      | 34,927            | 30,207      |
| General and administrative                                    | 18,608             | 13,194      | 51,611            | 36,545      |
| Amortization of certain acquired intangible assets            | —                  | 150         | 150               | 450         |
| Total operating expenses                                      | 84,428             | 77,056      | 254,914           | 217,861     |
| Loss from operations  | (10,039 )          | (17,031 )   | (41,793 )         | (53,873 )   |
| Other income (expense):                                       |                    |             |                   |             |
| Interest income   | 451                | 218         | 1,182             | 590         |
| Interest expense  | (3,245 )           | (3,138 )    | (9,652 )          | (9,343 )    |
| Other, net  | 663                | (66 )       | 2,938             | (3,257 )    |
| Other income (expense), net                                   | (2,131 )           | (2,986 )    | (5,532 )          | (12,010 )   |
| Loss before income tax provision                              | (12,170 )          | (20,017 )   | (47,325 )         | (65,883 )   |
| Income tax provision  | (218 )             | (132 )      | (894 )            | (790 )      |
| Net loss  | \$(12,388 )        | \$(20,149 ) | \$(48,219 )       | \$(66,673 ) |
| Net loss per share, basic and diluted                         | \$(0.22 )          | \$(0.37 )   | \$(0.87 )         | \$(1.24 )   |
| Weighted average common shares outstanding, basic and diluted | 55,964             | 54,260      | 55,359            | 53,917      |

See accompanying notes to unaudited condensed consolidated financial statements.

CORNERSTONE ONDEMAND, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(in thousands)

(unaudited)

|  | Three Months Ended |            | Nine Months Ended |            |
|--|--------------------|------------|-------------------|------------|
|  | September 30,      |            | September 30,     |            |
|  | 2016               | 2015       | 2016              | 2015       |
| Net loss   | \$(12,388)         | \$(20,149) | \$(48,219)        | \$(66,673) |
| Other comprehensive income, net of tax:                |                    |            |                   |            |
| Foreign currency translation adjustment                | 917                | 526        | 2,539             | 291        |
| Net change in unrealized (losses) gains on investments | (162)              | ) 41       | 306               | 105        |
| Other comprehensive income, net of tax                 | 755                | 567        | 2,845             | 396        |
| Total comprehensive loss                               | \$(11,633)         | \$(19,582) | \$(45,374)        | \$(66,277) |

See accompanying notes to unaudited condensed consolidated financial statements.

CORNERSTONE ONDEMAND, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (in thousands)  
 (unaudited)

|   | Nine Months Ended<br>September 30, |            |
|---|------------------------------------|------------|
|   | 2016                               | 2015       |
| Cash flows from operating activities:   |                                    |            |
| Net loss  | \$(48,219)                         | \$(66,673) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: |                                    |            |
| Depreciation and amortization   | 23,867                             | 19,897     |
| Accretion of debt discount and amortization of debt issuance costs                        | 6,805                              | 6,478      |
| Purchased investment premium, net of amortization   | 219                                | (94 )      |
| Net foreign currency (gain) loss  | (1,146 )                           | 1,669      |
| Stock-based compensation expense  | 40,750                             | 30,668     |
| Changes in operating assets and liabilities:  |                                    |            |
| Accounts receivable   | 1,056                              | (9,523 )   |
| Deferred commissions  | 1,688                              | (2,127 )   |
| Prepaid expenses and other assets   | (3,807 )                           | (4,789 )   |
| Accounts payable  | (4,937 )                           | (1,045 )   |
| Accrued expenses  | (5,211 )                           | 386        |
| Deferred revenue  | (7,490 )                           | 16,544     |
| Other liabilities   | (1,857 )                           | (675 )     |
| Net cash provided by (used in) operating activities                                       | 1,718                              | (9,284 )   |
| Cash flows from investing activities:   |                                    |            |
| Purchases of investments  | (174,992)                          | (162,191)  |
| Maturities of investments   | 130,229                            | 81,415     |
| Capital expenditures  | (4,345 )                           | (15,006 )  |
| Capitalized software costs  | (12,236 )                          | (9,996 )   |
| Net cash used in investing activities   | (61,344 )                          | (105,778)  |
| Cash flows from financing activities:   |                                    |            |
| Repayment of debt   | —                                  | (295 )     |
| Principal payments under capital lease obligations  | (33 )                              | (185 )     |
| Proceeds from employee stock plans  | 17,770                             | 9,197      |
| Net cash provided by financing activities   | 17,737                             | 8,717      |
| Effect of exchange rate changes on cash and cash equivalents                              | (512 )                             | (2,285 )   |
| Net decrease in cash and cash equivalents   | (42,401 )                          | (108,630)  |
| Cash and cash equivalents at beginning of period  | 107,691                            | 166,557    |
| Cash and cash equivalents at end of period  | \$65,290                           | \$57,927   |
| Supplemental cash flow information:   |                                    |            |
| Cash paid for interest  | \$3,796                            | \$1,914    |
| Cash paid for income taxes  | 1,837                              | 1,209      |
| Proceeds from employee stock plans received in advance of stock issuance                  | 1,485                              | 1,130      |
| Non-cash investing and financing activities:  |                                    |            |
| Capitalized assets financed by accounts payable and accrued expenses                      | \$1,993                            | \$538      |
| Capitalized stock-based compensation  | 3,111                              | 2,019      |

See accompanying notes to unaudited condensed consolidated financial statements.





CORNERSTONE ONDEMAND, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Company Overview

Cornerstone OnDemand, Inc. (“Cornerstone” or the “Company”) was incorporated on May 24, 1999 in the state of Delaware and began its principal operations in November 1999.

The Company is a leading global provider of human capital management solutions delivered as Software-as-a-Service (“SaaS”). The Company’s Enterprise and Mid-Market solution is a unified cloud-based platform that addresses critical talent needs throughout the entire employee lifecycle, from recruitment, onboarding, training and collaboration, to performance management, compensation, succession planning, people administration and analytics.

The Company’s solutions are designed to enable organizations to meet the challenges they face in empowering and maximizing the productivity of their human capital. These challenges include hiring and developing employees throughout their careers, engaging all employees effectively, improving business execution, cultivating future leaders, and integrating with an organization’s extended enterprise of clients, vendors and distributors by delivering training, certification programs and other content. The Company’s management has determined that the Company operates in one segment as it only reports financial information on an aggregate and consolidated basis to the Company’s chief executive officer, who is the Company’s chief operating decision maker.

Office Locations

The Company is headquartered in Santa Monica, California and has offices in Amsterdam, Auckland, Bangalore, Düsseldorf, Hong Kong, London, Madrid, Mumbai, Munich, New Delhi, Paris, San Francisco, São Paulo, Stockholm, Sunnyvale, Sydney, Tel Aviv, and Tokyo.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with (i) United States generally accepted accounting principles (“GAAP”) for interim financial information and (ii) the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, such financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, the financial statements include all adjustments (consisting of normal recurring adjustments) necessary for the fair presentation of the interim periods presented. Results for the three and nine months ended September 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016, for any other interim period or for any other future year.

The condensed consolidated balance sheet at December 31, 2015 has been derived from the audited financial statements at that date, but does not include all of the disclosures required by GAAP.

The Company’s significant accounting policies are described in “Note 2. Summary of Significant Accounting Policies” in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015. The Company follows the same accounting policies for interim reporting. The financial information included in this Quarterly Report on Form 10-Q should be read in conjunction with the Company’s consolidated financial statements and related notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015.

Recently Adopted Accounting Pronouncement

In April 2015, the Financial Accounting Standards Board (“FASB”) issued a new accounting standards update (“ASU”) to simplify presentation of debt issuance costs, which requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The guidance was effective for reporting periods beginning after December 15, 2015 and interim periods within those fiscal years. The Company adopted this accounting guidance as of March 31, 2016 on a retrospective basis. As a result of the adoption, the Company reclassified unamortized debt issuance costs of \$2.3 million and \$3.3 million as of September 30, 2016 and December 31, 2015, respectively, from Other assets, net and reflected them as a reduction in Convertible notes, net on the Condensed Consolidated Balance Sheets. The adoption of this guidance did not have a significant impact on the Company’s results of operations or financial position.



### Recent Accounting Pronouncements

In August 2016, the FASB issued a new ASU to clarify how companies present and classify certain cash receipts and cash payments in the statement of cash flows. This guidance is effective for our interim and annual reporting period beginning January 1, 2018. The Company is currently evaluating the effects of the adoption of this ASU on its financial statements.

In March 2016, the FASB issued a new ASU to simplify several areas of accounting for share-based compensation arrangements, including the income tax impact, classification on the statement of cash flows and forfeitures. This guidance is effective for our interim and annual reporting periods beginning January 1, 2017. The Company is currently evaluating the effects of the adoption of this ASU on its financial statements.

In February 2016, the FASB issued a new ASU, which amends a number of aspects of lease accounting, including requiring lessees to recognize operating leases with a term greater than one year on their balance sheet as a right-of-use asset and corresponding lease liability, measured at the present value of the lease payments. This guidance is effective for our interim and annual reporting periods beginning January 1, 2019. The Company is currently evaluating the effects of the adoption of this ASU on its financial statements.

In January 2016, the FASB issued a new ASU that provides guidance for the recognition, measurement, presentation, and disclosure of financial assets and liabilities. This guidance is effective for our interim and annual reporting periods beginning January 1, 2018. The Company is currently evaluating the effects of the adoption of this ASU on its financial statements.

In May 2014, the FASB issued a new ASU that provides principles for recognizing revenue for the transfer of promised goods or services to customers with the consideration to which the entity expects to be entitled in exchange for those goods or services. In July 2015, the FASB approved a one-year deferral of the effective date for the new standard. As a result, this guidance is effective for our interim and annual reporting periods beginning January 1, 2018. Early adoption is permitted beginning January 1, 2017. The Company is currently evaluating the accounting, transition and disclosure requirements of the standard and cannot currently estimate the financial statement impact of adoption.

### 2. NET LOSS PER SHARE

The following table presents the Company's basic and diluted net loss per share (in thousands, except per share amounts):

|   | Three Months Ended |            | Nine Months Ended |            |
|---|--------------------|------------|-------------------|------------|
|   | September 30,      |            | September 30,     |            |
|   | 2016               | 2015       | 2016              | 2015       |
| Net loss  | \$(12,388)         | \$(20,149) | \$(48,219)        | \$(66,673) |
| Weighted-average shares of common stock outstanding | 55,964             | 54,260     | 55,359            | 53,917     |
| Net loss per share – basic and diluted              | \$(0.22 )          | \$(0.37 )  | \$(0.87 )         | \$(1.24 )  |

At September 30, 2016 and 2015, the following shares were excluded from the computation of diluted net loss per share because the effect of these shares would have been anti-dilutive (in thousands):

|   | September 30, |        |
|---|---------------|--------|
|   | 2016          | 2015   |
| Options to purchase common stock and restricted stock units | 10,920        | 10,884 |
| Shares issuable pursuant to employee stock purchase plan    | 77            | 67     |
| Convertible notes   | 4,682         | 4,682  |
| Common stock warrants                                       | 4,682         | 4,682  |
| Total shares excluded from net loss per share               | 20,361        | 20,315 |

Under the treasury stock method, the convertible notes and common stock warrants will have a dilutive impact on net earnings per share when the average stock price for the period exceeds the respective conversion prices and the Company has net income. The Company also entered into note hedge transactions ("Note Hedges") in connection with the convertible notes with respect to its common stock to minimize the impact of potential economic dilution upon conversion of the convertible notes. The Note Hedges were outstanding as of September 30, 2016. Since the beneficial impact of the Note Hedges was anti-dilutive, they are excluded from the calculation of diluted net income (loss) per

share. See Note 6 of the Notes to Condensed Consolidated Financial Statements.

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### 3. INVESTMENTS

#### Investments in Marketable Securities

The Company's investments in available-for-sale marketable securities are made pursuant to its investment policy, which has established guidelines relative to the diversification of the Company's investments and their maturities, with the principal objective of capital preservation and maintaining liquidity that is sufficient to meet cash flow requirements.

The following is a summary of investments in marketable securities, including cash equivalents, as of September 30, 2016 (in thousands):

|                          | September 30, 2016         |                     |                      |               |
|--------------------------|----------------------------|---------------------|----------------------|---------------|
|                          | Amortized<br>Cost<br>Basis | Unrealized<br>Gains | Unrealized<br>Losses | Fair<br>Value |
| Money market funds       | \$31,636                   | \$ —                | \$ —                 | \$31,636      |
| Corporate bonds          | 49,541                     | 6                   | (30 )                | 49,517        |
| Agency bonds             | 36,980                     | 11                  | (21 )                | 36,970        |
| U.S. treasury securities | 140,878                    | 57                  | (20 )                | 140,915       |
| Commercial paper         | 16,257                     | —                   | —                    | 16,257        |
|                          | \$275,292                  | \$ 74               | \$ (71 )             | \$275,295     |

The following is a summary of investments in marketable securities, including cash equivalents, as of December 31, 2015 (in thousands):

|                          | December 31, 2015          |                     |                      |               |
|--------------------------|----------------------------|---------------------|----------------------|---------------|
|                          | Amortized<br>Cost<br>Basis | Unrealized<br>Gains | Unrealized<br>Losses | Fair<br>Value |
| Money market funds       | \$61,986                   | \$ —                | \$ —                 | \$61,986      |
| Corporate bonds          | 56,205                     | 3                   | (99 )                | 56,109        |
| Agency bonds             | 85,572                     | —                   | (111 )               | 85,461        |
| U.S. treasury securities | 58,004                     | 2                   | (98 )                | 57,908        |
|                          | \$261,767                  | \$ 5                | \$ (308 )            | \$261,464     |

As of September 30, 2016, the Company's investment in corporate bonds, agency bonds, U.S. treasury securities and commercial paper had a weighted-average maturity date of approximately nine months. Unrealized gains and losses on investments were not significant, and the Company does not believe the unrealized losses represent other-than-temporary impairments as of September 30, 2016 and December 31, 2015. No marketable securities held have been in a continuous unrealized loss position for more than 12 months as of September 30, 2016 and December 31, 2015.

#### Strategic Investments

The following is a summary of the Company's strategic investments in equity securities of privately-held companies as of September 30, 2016 (in thousands):

|                           |         |
|---------------------------|---------|
| September 2016 investment | \$ 500  |
| April 2016 investment     | 112     |
| December 2015 investment  | 350     |
| July 2015 investment      | 250     |
| May 2015 investment       | 500     |
| September 2014 investment | 360     |
|                           | \$2,072 |

The Company accounted for each of these investments using the cost method of accounting, as the Company does not have significant influence or a controlling financial interest over these entities. These investments are subject to periodic impairment reviews and are considered to be impaired when a decline in fair value is judged to be other-than-temporary. As of September 30, 2016, the Company determined there were no impairments of these

investments.

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In June 2014, the Company invested \$0.5 million in a debt security of a privately-held company. The Company accounted for this debt security as an available-for-sale security at fair value, which was determined to have no value as of September 30, 2016.

#### 4. INTANGIBLE ASSETS

The Company has finite-lived intangible assets which are amortized over the estimated useful lives on a straight-line basis. The following table presents the gross carrying amount and accumulated amortization of finite-lived intangible assets as of September 30, 2016 and December 31, 2015 (in thousands):

|                         | September 30, 2016    |                          |                     | December 31, 2015     |                          |                     |
|-------------------------|-----------------------|--------------------------|---------------------|-----------------------|--------------------------|---------------------|
|                         | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Developed technology    | \$29,984              | \$ (20,529 )             | \$ 9,455            | \$29,984              | \$ (13,732 )             | \$ 16,252           |
| Customer relationships  | 2,400                 | (2,400 )                 | —                   | 2,400                 | (2,242 )                 | 158                 |
| Software license rights | 1,654                 | (1,471 )                 | 183                 | 1,654                 | (1,351 )                 | 303                 |
| Total                   | \$34,038              | \$ (24,400 )             | \$ 9,638            | \$34,038              | \$ (17,325 )             | \$ 16,713           |

Total amortization expense from finite-lived intangible assets was \$2.2 million and \$7.1 million for the three and nine months ended September 30, 2016, respectively, and \$2.6 million and \$7.9 million for the three and nine months ended September 30, 2015, respectively. Amortization expense of \$2.2 million and \$6.9 million for the three and nine months ended September 30, 2016, respectively, and \$2.5 million and \$7.5 million for the three and nine months ended September 30, 2015, respectively, related to developed technology and software license rights was recorded in cost of revenue and the remainder was recorded in “Amortization of certain acquired intangible assets” in the accompanying Condensed Consolidated Statements of Operations.

The following table presents the Company’s estimate of remaining amortization expense, which will be recorded in cost of revenue, for each of the succeeding fiscal years ending December 31 for finite-lived intangible assets that existed at September 30, 2016 (in thousands):

|                   |         |
|-------------------|---------|
| Remainder of 2016 | \$2,218 |
| 2017              | 7,420   |
| Total             | \$9,638 |

The Company evaluates the recoverability of its long-lived assets with finite useful lives, including intangible assets, for impairment whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable. Based on the assessment of various factors in connection with the preparation of the Company’s financial statements for the quarter ended September 30, 2016, the Company does not believe there were any negative qualitative factors impacting the recoverability of the carrying values. There were no impairment charges related to identifiable intangible assets in the nine months ended September 30, 2016 and the year ended December 31, 2015.

#### 5. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value represents the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. Observable inputs are based on market data obtained from independent sources. The fair value hierarchy is based on the following three levels of inputs, of which the first two are considered observable and the last one is considered unobservable:

• Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

• Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

• Level 3 – Unobservable inputs.





Assets and liabilities measured at fair value on a recurring basis included the following as of September 30, 2016 and December 31, 2015 (in thousands):

|                          | September 30, 2016 |          |           |         | December 31, 2015 |          |           |         |
|--------------------------|--------------------|----------|-----------|---------|-------------------|----------|-----------|---------|
|                          | Fair Value         | Level 1  | Level 2   | Level 3 | Fair Value        | Level 1  | Level 2   | Level 3 |
| Cash equivalents         | \$31,636           | \$31,636 | \$—       | \$—     | —\$61,986         | \$61,986 | \$—       | \$—     |
| Corporate bonds          | 49,517             | —        | 49,517    | —       | 56,109            | —        | 56,109    | —       |
| Agency bonds             | 36,970             | —        | 36,970    | —       | 85,461            | —        | 85,461    | —       |
| U.S. treasury securities | 140,915            | —        | 140,915   | —       | 57,908            | —        | 57,908    | —       |
| Commercial paper         | 16,257             | —        | 16,257    | —       | —                 | —        | —         | —       |
| Strategic investments    | —                  | —        | —         | —       | 150               | —        | —         | 150     |
|                          | \$275,295          | \$31,636 | \$243,659 | \$—     | —\$261,614        | \$61,986 | \$199,478 | \$150   |

At September 30, 2016 and December 31, 2015, cash equivalents of \$31.6 million and \$62.0 million, respectively, consisted of money market funds with original maturity dates of three months or less backed by U.S. Treasury bills. As of September 30, 2016, corporate bonds, agency bonds, U.S. treasury securities and commercial paper were classified within Level 2 of the fair value hierarchy. The bonds were valued using information obtained from pricing services, which obtained quoted market prices from a variety of industry data providers, security master files from large financial institutions, and other third-party sources. The Company performed supplemental analysis to validate information obtained from its pricing services. As of September 30, 2016, no adjustments were made to such pricing information.

#### Strategic Investments

The Company's investments in privately-held companies are shown in the accompanying Condensed Consolidated Balance Sheets in Long-term investments and accompanying Condensed Consolidated Statements of Cash Flows in Purchases of investments. The strategic investments classified as debt securities are considered Level 3 in the fair value hierarchy as they have been valued using significant unobservable inputs or data from various valuation approaches and is measured each reporting period at fair value.

The following table presents a reconciliation of the investment in debt securities measured at fair value using significant unobservable inputs (Level 3) as of September 30, 2016 (in thousands):

|                                  |       |
|----------------------------------|-------|
| Balance as of December 31, 2015  | \$150 |
| Change in value                  | (150) |
| Balance as of September 30, 2016 | \$—   |

#### Senior Convertible Notes

The Company's senior convertible notes are shown in the accompanying Condensed Consolidated Balance Sheets at their original issuance value, net of unamortized discount and debt issuance costs, and are not re-measured to fair value each period. The approximate fair value of the Company's convertible notes as of September 30, 2016 was \$277.4 million. The fair value of the convertible notes was estimated on the basis of quoted market prices, which, due to limited trading activity, are considered Level 2 in the fair value hierarchy.

## 6. DEBT

#### Senior Convertible Notes

In 2013, the Company issued senior convertible notes (the "Notes") raising gross proceeds of \$253.0 million. The Notes are governed by an Indenture, dated June 17, 2013 (the "Indenture"), between the Company and U.S. Bank National Association, as trustee. The Notes mature on July 1, 2018, unless earlier repurchased or converted, and bear interest at a rate of 1.50% per year payable semi-annually in arrears on January 1 and July 1 of each year, commencing January 1, 2014.

The Notes are convertible at an initial conversion rate of 18.5046 shares of the Company's common stock per \$1,000 principal amount of the Notes, which represents an initial conversion price of approximately \$54.04 per share, subject to adjustment for anti-dilutive issuances, voluntary increases in the conversion rate and make-whole adjustments upon a fundamental change. A fundamental change includes a change in control, delisting of the Company's common stock and a liquidation of the Company. Upon conversion, the Company will deliver cash for the principal amount, and the Company has the right to settle any amounts in excess of the principal in cash or shares. Prior to April 1, 2018, the Notes are only convertible upon satisfaction of certain conditions as follows:

- during any calendar quarter after September 30, 2013, if the last reported sale price of common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day;
- during the five business day period after any five consecutive trading day period in which the trading price per \$1,000 principal amount of the Notes for each trading day of that five consecutive trading day period was less than 98% of the product of the last reported sale price of common stock and the conversion rate on each such trading day; or
- upon the occurrence of specified corporate events as defined in the Indenture.

Holders of the Notes may convert their Notes at any time on or after April 1, 2018, until the close of business on the second scheduled trading day immediately preceding the maturity date.

The holders of the Notes may require the Company to repurchase all or a portion of their Notes at a cash repurchase price equal to 100% of the principal amount of the Notes being repurchased, plus accrued and unpaid interest, upon a fundamental change and events of default, including non-payment of interest or principal and other obligations under the Indenture.

In accounting for the Notes at issuance, the Company separated the Notes into debt and equity components pursuant to the accounting standards for convertible debt instruments that may be fully or partially settled in cash upon conversion. The fair value of the debt component was estimated using an interest rate for nonconvertible debt, with terms similar to the Notes, excluding the conversion feature. 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 excess of the principal amount of the Notes over the fair value of the debt component was recorded as a debt discount and a corresponding increase in additional paid-in capital. The debt discount is accreted to interest expense over the term of the Notes using the interest method. The amount recorded to additional paid-in capital is not to be remeasured as long as it continues to meet the conditions for equity classification. Upon issuance of the \$253.0 million of Notes, the Company recorded \$214.3 million to debt and \$38.7 million to additional paid-in capital for the debt discount. The Company incurred transaction costs of approximately \$7.3 million related to the issuance of the Notes. In accounting for these costs, the Company allocated the costs to the debt and equity components in proportion to the allocation of proceeds from the issuance of the Notes to such components. Transaction costs allocated to the debt component of \$6.2 million are deferred and amortized to interest expense over the term of the Notes. The transaction costs allocated to the equity component of \$1.1 million were recorded to additional paid-in capital.

The net carrying amount of the liability component of the Notes as of September 30, 2016 consists of the following (in thousands):

|  |           |
|--|-----------|
| Principal amount   | \$253,000 |
| Unamortized debt discount                                  | (14,554 ) |
| Net carrying amount before unamortized debt issuance costs | 238,446   |
| Unamortized debt issuance costs                            | (2,336 )  |
| Net carrying amount  | \$236,110 |

The effective interest rate of the liability component of the Notes is 5.4%. This interest rate was based on the interest rates of similar liabilities at the time of issuance that did not have associated convertible features.

The following table presents the interest expense recognized related to the Notes for the three and nine months ended September 30, 2016 and 2015 (in thousands):

|  | Three Months Ended |         | Nine Months Ended |         |
|--|--------------------|---------|-------------------|---------|
|  | September 30,      |         | September 30,     |         |
|  | 2016               | 2015    | 2016              | 2015    |
| Contractual interest expense at 1.5% per annum | \$949              | \$949   | \$2,847           | \$2,846 |
| Amortization of debt issuance costs            | 318                | 302     | 942               | 896     |
| Accretion of debt discount                     | 1,978              | 1,884   | 5,863             | 5,582   |
| Total  | \$3,245            | \$3,135 | \$9,652           | \$9,324 |

The net proceeds from the Notes were approximately \$246.0 million after payment of the initial purchasers' offering expenses. The Company used approximately \$49.5 million of the net proceeds of the Notes offering to pay the cost of the Note Hedges described below, which was partially offset by \$23.2 million of the proceeds from the Company's sale of the Warrants also described below.

#### Note Hedges

Concurrent with the issuance of the Notes, the Company entered into note hedges (the "Note Hedges") with certain bank counterparties, with respect to its common stock. The Company paid \$49.5 million for the Note Hedges. The Note Hedges cover approximately 4.7 million shares of the Company's common stock at a strike price of \$54.04 per share, and are exercisable by the Company upon conversion of the Notes. The Note Hedges will expire upon the maturity of the Notes. The Note Hedges are intended to reduce the potential economic dilution upon conversion of the Notes in the event that the fair value per share of the Company's common stock at the time of exercise is greater than the conversion price of the Notes.

#### Warrants

Separately and concurrently with the entry by the Company into the Note Hedges, the Company entered into warrant transactions, whereby it sold warrants to the same bank counterparties as the Note Hedges to acquire up to 4.7 million shares of the Company's common stock at a strike price of \$80.06 per share (the "Warrants"), subject to anti-dilution adjustments. The Company received proceeds of \$23.2 million from the sale of the Warrants. The Warrants expire at various dates during 2018 and 2019. If the fair value per share of the Company's common stock exceeds the strike price of the Warrants, the Warrants will reduce diluted earnings per share to the extent that the calculation does not have an anti-dilutive effect.

The amounts paid and received for the Note Hedges and the Warrants have been recorded in additional paid-in capital. The fair value of the Note Hedges and the Warrants are not remeasured through earnings each reporting period.

## 7. STOCK-BASED AWARDS

#### Stock Options

The following table summarizes the Company's stock option activity for the nine months ended September 30, 2016 (in thousands, except per share and term information):

|                                 | Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term | Aggregate Intrinsic Value (1) |
|---------------------------------|--------|---------------------------------|---|-------------------------------|
| Outstanding, December 31, 2015  | 7,264  | \$ 30.75                        | 7.1   | \$ 63,328                     |
| Granted                         | 101    | 38.67                           |   |                               |
| Exercised                       | (784 ) | 18.17                           |   |                               |
| Forfeited                       | (241 ) | 44.00                           |   |                               |
| Outstanding, September 30, 2016 | 6,340  | \$ 31.95                        | 6.5   | \$ 94,986                     |



|   | Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term | Aggregate Intrinsic Value (1) |
|---|--------|---------------------------------|---|-------------------------------|
| Exercisable at September 30, 2016                 | 4,884  | \$ 29.03                        | 6.1   | \$ 87,084                     |
| Vested and expected to vest at September 30, 2016 | 6,289  | 31.87                           | 6.5   | 94,651                        |

(1)Based on the Company's closing stock price of \$45.95 on September 30, 2016 and \$34.53 on December 31, 2015. Unrecognized compensation expense relating to stock options was \$25.9 million at September 30, 2016, which is expected to be recognized over a weighted-average period of 1.6 years. The aggregate grant date fair value of stock options granted during the nine months ended September 30, 2016 was \$1.8 million.

### Restricted Stock Units

The Company granted restricted stock units covering 1.6 million shares of its common stock during the nine months ended September 30, 2016. At September 30, 2016, there were 3.2 million shares of the Company's common stock issuable upon the vesting of outstanding restricted stock units. Unrecognized compensation expense related to shares of the Company's common stock subject to unvested restricted stock units was \$94.6 million at September 30, 2016, which is expected to be recognized as expense over the weighted-average period of 3.1 years.

### Performance-Based Restricted Stock Units

In July 2014, the Compensation Committee of the Company's Board of Directors (the "Compensation Committee") approved the issuance of performance-based restricted stock units to an executive officer of the Company. The number of shares of the Company's common stock issuable upon the vesting of this performance-based restricted stock award is based upon (a) the performance of the Company's stock price relative to a certain independent market index and (b) the recipient continuing to provide service through the end of the three year term of the award. Achievement of the maximum performance level would result in the issuance of 60,900 shares. The Company used a Monte Carlo simulation to estimate the fair value of this award which factors in the probability of the award vesting. The grant date fair value of the award was \$1.8 million, which will be recognized ratably over the three year term of the award. In December 2014, the Compensation Committee approved the issuance of performance-based restricted stock units to certain executives of the Company. The number of shares of the Company's common stock issuable upon the vesting of these performance-based restricted stock unit awards is based upon (a) the performance of the Company's stock price relative to a certain independent market index, (b) the achievement of the Company's revenue guidance for each of fiscal year 2015 and 2016 and (c) the recipient continuing to provide services to the Company through the end of the three year term of the award. The Company finalizes its revenue guidance in February of each year, thus a grant date was established in February of 2015 and February of 2016 for each of the two tranches of the award related to that year's revenue guidance. Each tranche is treated as a separate grant and recognized from the date the revenue guidance is determined over the remaining portion of the original three year term of the award. Achievement of the maximum performance level would result in the issuance of an aggregate of 1,070,000 shares.

The Company used a Monte Carlo simulation to estimate the fair value each tranche of the awards for which a grant date has been established. The valuation factors in the probability of achieving the performance of the Company's stock price relative to the market index. The aggregate grant date fair value of the first half of the above awards was \$9.9 million, which was subsequently decreased to \$5.0 million based on the Company's performance in relation to the revenue guidance for fiscal year 2015. The decrease in value was a result of the maximum level of shares decreasing from an aggregate of 1,070,000 shares to an aggregate of 802,500 shares, representing a decrease from 535,000 shares to 267,500 shares for the first half of the awards and the maximum level achievable of 535,000 shares remaining for the second half of the awards. During the nine months ended September 30, 2016, the Company determined that the aggregate grant date fair value of the second half of the awards was \$3.6 million, which will be evaluated each reporting period to determine the Company's performance in relation to the revenue guidance for fiscal year 2016. Additionally, during the nine months ended September 30, 2016, an aggregate of 30,000 shares were forfeited as a result of the retirement of an executive officer of the Company.



In July 2016, the Compensation Committee approved the issuance of additional performance-based restricted stock units to certain executives of the Company. The number of shares of the Company's common stock issuable upon the vesting of these performance-based restricted stock unit awards is based upon (a) the Company meeting certain revenue and cash flow targets through December 31, 2018 and (b) the recipient continuing to provide services to the Company through the end of June 2019. Achievement of the maximum performance level would result in the issuance of 499,800 shares. The total amount of compensation expense recognized will be based on the number of estimated eligible shares, which will be evaluated each reporting period and determined by the Company's actual and projected revenue and cash flow performance. These awards have a grant date fair value of \$38.67 per share and the total compensation expense will be recognized over the three year vesting term of the awards.

The Company recognized compensation expense related to all performance-based awards in the aggregate amount of \$0.6 million and \$2.1 million for the three and nine months ended September 30, 2016, respectively. Unrecognized compensation expense related to unvested performance-based restricted stock units was \$6.0 million at September 30, 2016, based on the probable performance target at that date, which is expected to be recognized as expense over the weighted-average period of 1.7 years.

#### Employee Stock Purchase Plan

Under the Company's 2010 Employee Stock Purchase Plan ("ESPP"), eligible employees are granted the right to purchase shares at the lower of 85% of the fair market value of the stock at the time of grant or 85% of the fair market value at the time of exercise. The right to purchase shares is granted twice yearly for six month offering periods in June and December and exercisable on or about the succeeding December and June, respectively, on each year.

#### Stock-Based Compensation

Stock-based compensation expense related to stock options, restricted stock units, the ESPP and performance-based restricted stock units is included in the following line items in the accompanying Condensed Consolidated Statement of Operations for the three and nine months ended September 30, 2016 and 2015 (in thousands):

|                                    | Three Months<br>Ended<br>September 30,<br>2016 |          | Nine Months<br>Ended<br>September 30,<br>2015 |          |
|------------------------------------|--|----------|---|----------|
|                                    | 2016   | 2015     | 2016  | 2015     |
| Cost of revenue                    | \$1,215  | \$1,106  | \$3,477                                       | \$2,769  |
| Sales and marketing expense        | 6,741  | 6,672    | 19,186  | 16,869   |
| Research and development expense   | 2,144  | 1,663    | 5,777   | 4,175    |
| General and administrative expense | 4,646  | 2,726    | 12,310  | 6,855    |
| Total                              | \$14,746                                       | \$12,167 | \$40,750                                      | \$30,668 |

## 8. INCOME TAXES

The Company's income tax provision was approximately \$0.2 million and \$0.9 million with an effective income tax rate of (1.8)% and (1.9)% for the three and nine months ended September 30, 2016, respectively. The Company's effective tax rate differs from the statutory rate primarily due to the change in the valuation allowance on the Company's deferred tax assets and foreign income taxes.

The income tax provision is related to certain foreign income, state income and withholding taxes. We do not have a tax provision in the significant jurisdictions we operate in, such as the United States and United Kingdom, as we have generated losses and have recorded a full valuation allowance against the net deferred tax assets and we do not anticipate recording an income tax benefit related to these deferred tax assets. The Company will reassess the realization of deferred tax assets each reporting period and will be able to reduce the valuation allowance to the extent that the financial results of these operations improve and it becomes more likely than not that the deferred tax assets are realizable.

The Company is subject to U.S. federal income tax, state income tax and various foreign income taxes. The Company is subject to examination for the 2013 through 2015 tax years for its U.S. federal income tax returns. State income tax returns are subject to examination for the 2011 through 2015 tax years. The Company is subject to examination by various foreign jurisdictions for years after 2007. The Company does not reasonably expect significant changes to its

uncertain tax positions within the next twelve months.

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## 9. COMMITMENTS AND CONTINGENCIES

### Guarantees and Indemnifications

The Company has made guarantees and indemnities under which it may be required to make payments to a guaranteed or indemnified party in relation to certain transactions, including revenue transactions in the ordinary course of business. The Company is obligated to indemnify its directors and officers to the maximum extent permitted under the laws of the State of Delaware. However, the Company has a directors and officers insurance policy that may reduce its exposure in certain circumstances and may enable it to recover a portion of future amounts that may be payable, if any. The duration of the guarantees and indemnities varies and, in many cases, is indefinite but subject to statutes of limitations. To date, the Company has made no payments related to these guarantees and indemnities. The Company estimates the fair value of its indemnification obligations as insignificant based on this history and the Company's insurance coverage and therefore has not recorded any liability for these guarantees and indemnities in the accompanying condensed consolidated balance sheets.

### Lease Commitments

During the nine months ended September 30, 2016, the Company entered into various operating lease agreements with obligations of approximately \$0.3 million in 2016 and \$0.6 million in 2017.

### Other Commitments

In September 2016, the Company entered into a sponsorship agreement with a professional sports franchise with obligations of approximately \$2.7 million in 2017, \$0.7 million in 2018 and \$0.7 million in 2019.

In February 2016, the Company amended an agreement with one of its third-party service providers, whereby the Company committed to provide certain dollar amounts of professional service projects related to implementation and other services for clients of the Company. The amendment increased the contractual commitment amount by \$0.5 million in each of 2016 and 2017.

### Litigation

The Company is subject to various legal proceedings and claims that arise in the ordinary course of business. If the Company determines that it is probable that a loss has been incurred and the amount is reasonably estimable, the Company will record a liability. The Company has determined that it does not have a potential liability related to any legal proceedings or claims that would individually or in the aggregate materially adversely affect its financial condition or operating results.

## 10. RELATED PARTY TRANSACTIONS

In 2010, the Cornerstone OnDemand Foundation (the "Foundation"), was formed to empower communities in the United States and internationally by increasing the impact of the non-profit sector through the utilization of human capital management technology including the Company's Enterprise and Mid-Market solution. The Company's Chief Executive Officer is on the Board of Directors of the Foundation. The Company does not direct the Foundation's activities, and accordingly, the Company does not consolidate the Foundation's statement of activities with its financial results. During the three months ended September 30, 2016 and 2015, the Company provided at no charge certain resources to the Foundation, with approximate values of \$0.8 million and \$0.9 million, respectively, and for the nine months ended September 30, 2016 and 2015 values of \$2.5 million and \$2.2 million, respectively.

During June 2010, an executive officer of an accounting software company joined the Company's Board of Directors and resigned in September 2016. During the three months ended September 30, 2016 and 2015, the Company recorded \$0.1 million and \$0.2 million, respectively, and for the nine months ended September 30, 2016 and 2015 recorded \$0.6 million and \$0.4 million, respectively, in expenses related to the use of the accounting software from the company whose executive officer served on the Company's Board of Directors during those years.

## 11. SUBSEQUENT EVENTS

During October and November 2016, the Compensation Committee granted restricted stock units covering an aggregate of 151,700 shares of the Company's common stock which generally vest annually over four years.

## 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 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are any statements that look to future events and consist of, among other things, statements regarding our business strategies; anticipated future operating results and operating expenses; our ability to attract new clients to enter into subscriptions for our solutions; our ability to service those clients effectively and induce them to renew and upgrade their deployments of our solutions; our ability to expand our sales organization to address effectively the new industries, geographies and types of organizations we intend to target; our ability to accurately forecast revenue and appropriately plan our expenses; market acceptance of enhancements to our solutions; alternate ways of addressing human capital management needs or new technologies generally by us and our competitors; continued acceptance of SaaS as an effective method for delivering human capital management solutions and other business management applications; the attraction and retention of qualified employees and key personnel; our ability to protect and defend our intellectual property; costs associated with defending intellectual property infringement and other claims; events in the markets for our solutions and alternatives to our solutions, as well as in the United States and global markets generally; future regulatory, judicial and legislative changes in our industry; and changes in the competitive environment in our industry and the markets in which we operate. In addition, forward-looking statements also consist of statements involving trend analyses and statements including such words as "may," "believe," "could," "anticipate," "would," "might," "p expect," and similar expressions or the negative of such terms or other comparable terminology. These forward-looking statements speak only as of the date of this Quarterly Report on Form 10-Q and are subject to business and economic risks. As such, our actual results could differ materially from those set forth in the forward-looking statements as a result of the factors set forth below in Part II, Item 1A, "Risk Factors," and in our other reports filed with the Securities and Exchange Commission. We assume no obligation to update the forward-looking statements to reflect events that occur or circumstances that exist after the date on which they were made.

The following discussion should be read in conjunction with our unaudited condensed consolidated financial statements and notes thereto appearing elsewhere in this Quarterly Report on Form 10-Q.

### Overview

Cornerstone OnDemand is one of the world's largest cloud computing companies with 2,805 clients across approximately 27.7 million users in 191 countries and 42 different languages. We help organizations around the globe recruit, retain and develop their employees using human capital management solutions delivered as Software-as-a-Service, or SaaS. Our human capital management suite enables organizations to manage the entire employee lifecycle, with a focus on continuous learning and development, to empower employees to realize their potential and drive success within their organization.

We work with clients across all geographies, verticals and market segments to address critical talent needs throughout the entire employee lifecycle. Our Recruiting, Learning, Performance and People Administration modules help with sourcing, recruiting, and onboarding new hires; managing training and development requirements; connecting employees with other individuals in the organization; goal setting and performance reviews; as well as linking compensation to performance; identifying development plans based on performance gaps; and then utilizing all of that data for mobility within the organization. Recently, we strengthened these product offerings with a full Analytics suite that enables our clients to make smarter, more strategic, and more informed decisions around their talent.

Within the Learning module, we also offer Extended Enterprise and Cornerstone for Salesforce to Enterprise and Mid-Market clients. Extended Enterprise allows clients to train and develop their extended ecosystem of vendors, distributors, and customers with certification programs, trainings and other content. Cornerstone for Salesforce is a cloud-based learning solution developed natively on the Salesforce.com platform that allows organizations to seamlessly access sales enablement and just-in-time training embedded within Salesforce.

In addition to our human capital management suite for clients upmarket, we also offer Cornerstone Growth Edition, which is a cloud-based talent management solution with learning and performance product offerings targeted to organizations with 250 or fewer employees. We currently do not include the number of clients and users of our Cornerstone for Salesforce and Cornerstone Growth Edition solutions in our client and user count metrics as they are not significant and we believe the client and user count metrics for our Enterprise and Mid-Market solution give a

better indication of our overall performance.

We also provide consulting services in implementation of our solutions through configuration, system integration, business process re-engineering, change management and training services. After the initial purchase of our solution, we continue to market and sell to our existing clients, who may renew their subscriptions, add additional products, broaden the deployment of the solution across their organizations and increase usage of the solution over time.

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We generate most of our revenue from the sale of our solutions pursuant to multi-year client agreements. Client agreements for our Enterprise and Mid-Market solution typically have terms of three years. Our sales processes are typically competitive, and sales cycles generally vary in duration from two to nine months depending on the size of the potential client. We generally price our Enterprise and Mid-Market solution based on the number of products purchased and the permitted number of users with access to each product.

We sell our solutions through our direct sales teams and, to a lesser extent, indirectly through our distributors. We intend to continue to invest in our direct sales and distribution activities to address our market opportunity.

We generally recognize revenue from subscriptions ratably over the term of the client agreement and revenue from consulting services as the services are performed. In certain instances, our clients request enhancements to the underlying features and functionality of our Enterprise and Mid-Market solution, and in these instances, revenue from subscriptions is recognized over the remaining term of the agreement once the additional features are delivered to the client. We generally invoice our clients upfront for a portion of the annual subscription fees for multi-year subscriptions and upfront for consulting services. We record amounts invoiced for annual subscription periods that have not occurred or services that have not been performed as deferred revenue on our balance sheet. With the growth in the number of clients, our revenue grew to \$107.8 million and \$314.1 million for the three and nine months ended September 30, 2016, respectively, from \$87.3 million and \$243.8 million for the three and nine months ended September 30, 2015, respectively.

We have historically experienced seasonality in terms of when we enter into client agreements. We usually sign a significantly higher percentage of agreements with new clients, as well as renewal agreements with existing clients, in the fourth quarter of each year. In addition, within a given quarter, we typically sign a large portion of these agreements during the last month, and often the last two weeks, of that quarter. We believe this seasonality is driven by several factors, most notably the tendency of procurement departments at our enterprise clients to purchase technology at the end of a quarter or calendar year, possibly in order to use up their available quarterly or annual funding allocations, or to be able to deploy new human capital management capabilities prior to the beginning of a new financial or performance period. As the terms of most of our client agreements are measured in full year increments, agreements initially entered into the fourth quarter or last month of any quarter will generally come up for renewal at that same time in subsequent years. This seasonality is reflected to a much lesser extent, and sometimes is not immediately apparent, in our revenue, due to the fact that we recognize subscription revenue over the term of the client agreement, which is generally three years. In addition, this seasonality is reflected in changes in our deferred revenue balance, which generally is impacted by the timing of when we enter into agreements with new clients, invoice new clients, invoice existing clients for annual subscription periods and recognize revenue. We expect this seasonality to continue, which may cause fluctuations in certain of our operating results and financial metrics, and thus limit our ability to predict future results.

We believe the market for human capital management remains large and underpenetrated, providing us with significant growth opportunities. We expect businesses and other organizations to continue to increase their spending on human capital management solutions in order to maximize the productivity of their employees, manage changing workforce demographics and ensure compliance with global regulatory requirements. Historically, many of these software solutions have been human resource applications running on hardware located on organizations' premises. We have seen many of these organizations increasingly choose SaaS for their human capital management solutions and we anticipate that trend will continue.

We have focused on growing our business to pursue what we believe is a significant market opportunity, and we plan to continue to invest in building for growth. As a result, we expect our cost of revenue and operating expenses to increase in future periods. Sales and marketing expenses are expected to increase, as we continue to expand our direct sales teams, increase our marketing activities, and grow our international operations. Research and development expenses are expected to increase as we continue to improve the existing functionality for our solutions. We also believe that we must invest in maintaining a high degree of client service and support that is critical for our continued success. We plan to continue our policy of implementing best practices across our organization, expanding our technical operations and investing in our network infrastructure and service capabilities in order to support continued future growth. We also expect to incur additional general and administrative expenses as a result of our growth.



Our quarterly operating results have fluctuated in the past and may continue to fluctuate in the future based on a number of factors, many of which are beyond our control, including those described in the “Risk Factors” section of this Quarterly Report on Form 10-Q. One or more of these factors may cause our operating results to vary widely. As such, we believe that our quarterly results of operations may vary significantly in the future and that period-to-period comparisons of our operating results may not be meaningful and should not be relied upon as an indication of future performance.

#### Metrics

We regularly review a number of metrics, including the following key metrics, to evaluate our business, measure our performance, identify trends affecting our business, formulate financial projections and make strategic decisions.

**Revenue.** We generally recognize subscription revenue over the contract period, and as a result of our revenue recognition policy and the seasonality of when we enter into new client agreements, revenue from client agreements signed in the current period may not be fully reflected in the current period.

**Billings.** Under our revenue recognition policy, we generally recognize subscription revenue from our client agreements ratably over the terms of those agreements. For this reason, the major portion of our revenue for a period will be from client agreements signed in prior periods rather than from new business activity during the current period. In order to assess our business performance with a metric that more fully reflects current period business activity, we track billings (formerly referred to as “bookings”), which is a non-GAAP financial measure we define as the sum of revenue and the change in the deferred revenue balance for the period. We include changes in the deferred revenue balance to calculate billings so it better reflects new business activity in the period as evidenced by prepayments or billings under our billing policies arising from acquisition of new clients, sales of additional products to existing clients, the addition of incremental users by existing clients and client renewals. Billings are affected by our billing terms, and any changes in those billing terms may shift billings between periods. Due to the seasonality of our sales, billings growth is inconsistent from quarter to quarter throughout a calendar year. Additionally, billings growth can be impacted by fluctuations in foreign exchange rates. For a reconciliation of billings to revenue, please see “Results of Operations – Revenue and Metrics.”

**Constant currency results.** We present constant currency information, a non-GAAP financial measure, to provide a framework for assessing how our underlying business performed excluding the effect of foreign currency fluctuations. Due to our legal structure, our international revenues are favorably impacted as the United States dollar weakens relative to the British pound, and unfavorably impacted as the United States dollar strengthens relative to the British pound. We believe the presentation of results on a constant currency basis in addition to reported results helps improve the ability to understand our performance because they exclude the effects of foreign currency volatility that are not indicative of our core operating results. To present this information, current period results for entities reporting in British pounds are translated into United States dollars at the prior period exchange rates as opposed to the actual exchange rates in effect for the current period. These results should be considered in addition to, not as a substitute for, results reported in accordance with GAAP. Results on a constant currency basis, as we present them, may not be comparable to similarly titled measures used by other companies and are not a measure of performance presented in accordance with GAAP.

**Number of Clients.** We believe that our ability to expand our client base is an indicator of our market penetration and the growth of our business as we continue to invest in our direct sales teams and distributors. Our client count includes contracted clients for our Enterprise and Mid-Market solution as of the end of the period and excludes clients of our Cornerstone for Salesforce and Cornerstone Growth Edition solutions.

**Number of Users.** Since our clients generally pay fees based on the number of users of our solutions within their organizations, we believe the total number of users is an indicator of the growth of our business. Our user count includes active users for our Enterprise and Mid-Market solution and excludes users of our Cornerstone for Salesforce and Cornerstone Growth Edition solutions.

## Key Components of Our Results of Operations

### Sources of Revenue and Revenue Recognition

Our solutions are designed to enable organizations to meet the challenges they face in maximizing the productivity of their human capital. We generate revenue from the following sources:

**Subscriptions to Our Solutions.** Clients pay subscription fees for access to our solutions and support for a specified period of time, typically three years for our Enterprise and Mid-Market solution. Fees are based on a number of factors, including the number of products purchased, which may include e-learning content, and the number of users having access to a solution. We generally recognize revenue from subscriptions ratably over the term of the agreements.

**Professional Services and Other.** We offer our clients assistance in implementing our solutions and optimizing their use. Professional services include application configuration, system integration, business process re-engineering, change management and training services. Services are billed either on a time-and-material or a fixed-fee basis. These services are generally purchased as part of a subscription arrangement and are typically performed within the first several months of the arrangement. Clients may also purchase professional services at any other time. We generally recognize revenue from fixed fee professional services using the proportional performance method over the period the services are performed and as time is incurred for time-and-material arrangements.

Our client agreements generally include both a subscription to access our solutions and related professional services. Our agreements generally do not contain any cancellation or refund provisions other than in the event of our default.

### Cost of Revenue

Cost of revenue consists primarily of costs related to hosting our solutions; personnel and related expenses, including stock-based compensation, for network infrastructure, IT support, consulting services and on-going client support; payments to external service providers contracted to perform implementation services; depreciation of data centers; amortization of capitalized software costs; amortization of developed technology and software license rights; content and licensing fees; and referral fees. In addition, we allocate a portion of overhead, such as rent, IT costs, depreciation and amortization and employee benefits costs, to cost of revenue based on headcount. The costs associated with providing consulting services are significantly higher as a percentage of revenue than the costs associated with providing access to our solutions due to the labor costs to provide the consulting services. We expect gross margin to increase over time as we optimize the efficiency of our operations and continue to scale our business.

### Operating Expenses

Our operating expenses are as follows:

**Sales and Marketing.** Sales and marketing expenses consist primarily of personnel and related expenses for our sales and marketing staff, including salaries, benefits, bonuses, stock-based compensation and commissions; costs of marketing and promotional events, corporate communications, online marketing, product marketing and other brand-building activities; and allocated overhead.

We intend to continue to invest in sales and marketing strategically to expand our business both domestically and internationally. We expect sales and marketing expenses as a percentage of revenue to decrease.

**Research and Development.** Research and development expenses consist primarily of personnel and related expenses for our research and development staff, including salaries, benefits, bonuses and stock-based compensation; the cost of certain third-party service providers; and allocated overhead. Research and development costs, other than software development costs qualifying for capitalization, are expensed as incurred.

We have focused our research and development efforts on continuously improving our solutions. We believe that our research and development activities are efficient because we benefit from maintaining a single software code base for each of our solutions. We expect research and development expenses to increase proportionately with our business and expand our network infrastructure.

**General and Administrative.** General and administrative expenses consist primarily of personnel and related expenses for administrative, legal, finance and human resource staff, including salaries, benefits, bonuses and stock-based compensation; professional fees; insurance premiums; other corporate expenses; and allocated overhead. We expect our general and administrative expenses as a percentage of revenue to decrease.

**Amortization of Certain Acquired Intangible Assets.** Amortization of certain acquired intangible assets consists of amortization of acquisition-related intangibles for customer relationships.

#### **Other Income (Expense)**

**Interest Income.** Interest income consists primarily of interest income from investment securities partially offset by amortization of investment premiums. We expect interest income to vary depending on the level of our investments in marketable securities, which include corporate bonds, agency bonds, U.S. treasury securities and commercial paper in the three and nine months ended September 30, 2016.

**Interest Expense.** Interest expense consists primarily of interest expense from our convertible debt, accretion of debt discount and amortization of debt issuance costs.

**Other, Net.** Other, net consists of income and expense associated with fluctuations in foreign currency exchange rates, fair value adjustments to strategic investments and other non-operating expenses. We expect other income (expense) to vary depending on the movement in foreign currency exchange rates and the related impact on our foreign exchange gain (loss).

#### **Income Tax Provision**

The income tax provision is related to foreign and certain state income taxes. Given our historical losses, we have not recorded a provision, except for state minimum taxes and withholding taxes, for United States, United Kingdom, New Zealand, Hong Kong and Brazil income taxes as we have recorded a full valuation allowance against the net deferred tax assets for each of these countries. Other foreign subsidiaries and branches provide intercompany services and are compensated on a cost-plus basis, and therefore, have incurred liabilities for foreign income taxes in their respective jurisdictions.

#### **Critical Accounting Policies and Estimates**

Information with respect to our critical accounting policies that we believe have the most significant effect on our reported results and require subjective or complex judgments of management are contained in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of our Annual Report on Form 10-K filed with the Securities and Exchange Commission, or SEC, on February 27, 2016.

As of September 30, 2016, there have been no material changes to our critical accounting policies since December 31, 2015.

#### **Recent Accounting Pronouncements**

For information regarding recent accounting pronouncements, refer to Note 1 of Notes to Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.



## Results of Operations

The following table sets forth our results of operations for each of the periods indicated (in thousands). The period-to-period comparison of financial results is not necessarily indicative of future results.

|  | Three Months Ended |             | Nine Months Ended |             |
|--|--------------------|-------------|-------------------|-------------|
|  | September 30,      |             | September 30,     |             |
|  | 2016               | 2015        | 2016              | 2015        |
| Revenue                                      | \$107,758          | \$87,271    | \$314,095         | \$243,789   |
| Cost of revenue                              | 33,369             | 27,246      | 100,974           | 79,801      |
| Gross profit                                 | 74,389             | 60,025      | 213,121           | 163,988     |
| Operating expenses:                          |                    |             |                   |             |
| Sales and marketing                          | 53,690             | 53,255      | 168,226           | 150,659     |
| Research and development                     | 12,130             | 10,457      | 34,927            | 30,207      |
| General and administrative                   | 18,608             | 13,194      | 51,611            | 36,545      |
| Amortization of certain acquired intangibles | —                  | 150         | 150               | 450         |
| Total operating expenses                     | 84,428             | 77,056      | 254,914           | 217,861     |
| Loss from operations                         | (10,039 )          | (17,031 )   | (41,793 )         | (53,873 )   |
| Other income (expense):                      |                    |             |                   |             |
| Interest income                              | 451                | 218         | 1,182             | 590         |
| Interest expense                             | (3,245 )           | (3,138 )    | (9,652 )          | (9,343 )    |
| Other, net                                   | 663                | (66 )       | 2,938             | (3,257 )    |
| Loss before income tax provision             | (12,170 )          | (20,017 )   | (47,325 )         | (65,883 )   |
| Income tax provision                         | (218 )             | (132 )      | (894 )            | (790 )      |
| Net loss                                     | \$(12,388 )        | \$(20,149 ) | \$(48,219 )       | \$(66,673 ) |

The following table sets forth our revenue and key metrics that we use to evaluate our business, measure our performance, identify trends affecting our business, formulate financial projections and make strategic decisions:

## Metrics

|                               | At or For Three Months Ended |            | At or For Nine Months Ended |            |
|-------------------------------|------------------------------|------------|-----------------------------|------------|
|                               | September 30,                |            | September 30,               |            |
|                               | 2016                         | 2015       | 2016                        | 2015       |
| Revenue (in thousands)        | \$ 107,758                   | \$ 87,271  | \$ 314,095                  | \$ 243,789 |
| Billings (in thousands)       | \$ 106,991                   | \$ 103,683 | \$ 297,023                  | \$ 258,449 |
| Number of clients             | 2,805                        | 2,466      | 2,805                       | 2,466      |
| Number of users (in millions) | 27.7                         | 22.2       | 27.7                        | 22.2       |

Revenue increased by \$20.5 million, or 23%, for the three months ended September 30, 2016 as compared to the same period in 2015 and increased by \$70.3 million, or 29%, for the nine months ended September 30, 2016 as compared to the same period in 2015. Revenue growth on a constant currency basis represented a 30% increase for the three months ended September 30, 2016 as compared to the same period in 2015 and a 33% increase for the nine months ended September 30, 2016 as compared to the same period in 2015. The rate of our revenue increase can be impacted by the mix and timing of new client agreements signed, the mix of subscription and professional services revenue, the timing of delivery of our professional services revenue, fluctuations in foreign exchange rates, as well as the growth rate of our emerging markets.

The following table sets forth our revenue by type for each of the periods indicated (dollars in thousands):

|  | Three Months Ended |          | Nine Months Ended |           |
|--|--------------------|----------|-------------------|-----------|
|  | September 30,      |          | September 30,     |           |
|  | 2016               | 2015     | 2016              | 2015      |
| Subscription revenue                                 | \$86,366           | \$70,465 | \$250,300         | \$195,930 |
| Percentage of subscription revenue to total revenue  | 80.1               | % 80.7   | % 79.7            | % 80.4    |
| Professional services revenue                        | \$21,392           | \$16,806 | \$63,795          | \$47,859  |
| Percentage of professional services to total revenue | 19.9               | % 19.3   | % 20.3            | % 19.6    |
|  | \$107,758          | \$87,271 | \$314,095         | \$243,789 |

Subscription revenue increased by \$15.9 million for the three months ended September 30, 2016 as compared to the same period in 2015 and increased by \$54.4 million for the nine months ended September 30, 2016 as compared to the same period in 2015. The increase was attributable to new business, which includes new clients, upsells and renewals from existing clients during the three months ended September 30, 2016. Professional services revenue increased by \$4.6 million for the three months ended September 30, 2016 as compared to the same period in 2015 and increased by \$15.9 million for the nine months ended September 30, 2016 as compared to the same period in 2015. The increase was primarily due to higher demand for professional services from an increased number of clients at the top end of the market, who generally experience a higher mix of services relative to the total deal size.

Revenue by geography is generally based on the address of the customer as defined in our master subscription agreement. The following table sets forth our revenue by geographic area for each of the periods indicated (dollars in thousands):

|   | Three Months Ended |          | Nine Months Ended |           |
|---|--------------------|----------|-------------------|-----------|
|   | September 30,      |          | September 30,     |           |
|   | 2016               | 2015     | 2016              | 2015      |
| Revenue for United States                           | \$72,438           | \$57,552 | \$211,980         | \$165,611 |
| Percentage of total revenue for United States       | 67.2               | % 65.9   | % 67.5            | % 67.9    |
| Revenue for all other countries                     | \$35,320           | \$29,719 | \$102,115         | \$78,178  |
| Percentage of total revenue for all other countries | 32.8               | % 34.1   | % 32.5            | % 32.1    |
|   | \$107,758          | \$87,271 | \$314,095         | \$243,789 |

Billings increased \$3.3 million, or 3% and \$38.6 million, or 15%, respectively, for the three and nine months ended September 30, 2016 as compared to the same period in 2015, reflecting the increase in revenue for the period, plus an increase in deferred revenue compared to the same period in 2015. Billings growth on a constant currency basis represented a 9% and 21% increase, respectively, for the three and nine months ended September 30, 2016 as compared to the same periods in 2015. The growth rates for revenue and billings are not correlated with each other in a given period due to the seasonality of when we enter into client agreements, fluctuations in foreign exchange rates, the varied timing of billings, the recognition of subscription revenue generally on a straight-line basis over the term of each client agreement, and the recognition of professional services revenue generally on a proportional performance basis over the period the services are performed.

As discussed above under the heading "Metrics," billings is a non-GAAP financial measure defined as the sum of revenue and the change in the deferred revenue balance for the period. Management uses billings in analyzing its financial results and believes it is useful to investors, as a supplement to the corresponding GAAP measure, in evaluating our ongoing operational performance and trends and in comparing our financial measures with other companies in the same industry. However, it is important to note that other companies, including companies in our industry, may calculate billings differently or not at all, which may reduce its usefulness as a comparative measure.

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The following table presents a reconciliation of revenue to billings for each of the periods presented (in thousands):

|  | Deferred<br>Revenue<br>Balance | Three Months Ended<br>September 30, 2016 |
|--|--------------------------------|--|
| Revenue                                |                                | \$ 107,758                               |
| Deferred revenue at June 30, 2016      | \$235,834                      |  |
| Deferred revenue at September 30, 2016 | 235,067                        |  |
| Change in deferred revenue             | (767                           | )  |
| Billings                               |                                | \$ 106,991                               |

|  | Deferred<br>Revenue<br>Balance | Three Months Ended<br>September 30, 2015 |
|--|--------------------------------|--|
| Revenue                                |                                | \$ 87,271                                |
| Deferred revenue at June 30, 2015      | \$189,584                      |  |
| Deferred revenue at September 30, 2015 | 205,996                        |  |
| Change in deferred revenue             | 16,412                         |  |
| Billings                               |                                | \$ 103,683                               |

|  | Deferred<br>Revenue<br>Balance | Nine Months Ended<br>September 30, 2016 |
|--|--------------------------------|---|
| Revenue                                |                                | \$ 314,095                              |
| Deferred revenue at December 31, 2015  | \$252,139                      |   |
| Deferred revenue at September 30, 2016 | 235,067                        |   |
| Change in deferred revenue             | (17,072                        | )                                       |
| Billings                               |                                | \$ 297,023                              |

|  | Deferred<br>Revenue<br>Balance | Nine Months Ended<br>September 30, 2015 |
|--|--------------------------------|---|
| Revenue                                |                                | \$ 243,789                              |
| Deferred revenue at December 31, 2014  | \$191,336                      |   |
| Deferred revenue at September 30, 2015 | 205,996                        |   |
| Change in deferred revenue             | 14,660                         |   |
| Billings                               |                                | \$ 258,449                              |

We believe our revenue and billings growth is a result of our continued investment in and development of our direct sales team. We believe these investments have enabled us to achieve greater sales coverage and better sales execution. In addition, we have increased our marketing activities, which we believe has improved brand awareness and created higher demand for our solutions. We have also continued to enhance our Enterprise and Mid-Market solution, which we believe has encouraged existing clients to buy multiple products with their initial purchase and add additional products and users over the term of their agreement.

Our number of clients grew 14% at September 30, 2016 compared to September 30, 2015 and number of users increased 25% at September 30, 2016 compared to September 30, 2015.

Cost of Revenue, Gross Profit and Gross Margin

| Three Months Ended     |      | Nine Months Ended |      |
|------------------------|------|-------------------|------|
| 2016                   | 2015 | 2016              | 2015 |
| (dollars in thousands) |      |                   |      |

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|                 |          |          |           |           |   |
|-----------------|----------|----------|-----------|-----------|---|
| Cost of revenue | \$33,369 | \$27,246 | \$100,974 | \$79,801  |   |
| Gross profit    | \$74,389 | \$60,025 | \$213,121 | \$163,988 |   |
| Gross margin    | 69.0     | % 68.8   | % 67.9    | % 67.3    | % |

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Cost of revenue increased \$6.1 million, or 22%, for the three months ended September 30, 2016 as compared to the same period in 2015. The increase in cost of revenue is consistent with the increase in revenue. The increase in cost of revenue was primarily due to \$2.8 million in increased costs related to outsourced consulting services, \$1.2 million in increased amortization of capitalized software and \$0.7 million in increased employee-related costs due to higher headcount. These costs were incurred to service our existing clients and support our continued growth. The remaining increase relates to various other costs associated with generating revenue from our clients.

Cost of revenue increased \$21.2 million, or 27%, for the nine months ended September 30, 2016 as compared to the same period in 2015. The increase in cost of revenue is consistent with the increase in revenue. The increase in cost of revenue was primarily due to \$9.8 million in increased costs related to outsourced consulting services, \$3.3 million in increased employee-related costs due to higher headcount and \$3.0 million in increased amortization of capitalized software. These costs were incurred to service our existing clients and support our continued growth. The remaining increase relates to various other costs associated with generating revenue from our clients.

The following table presents our estimate of remaining amortization expense, which will be recorded in cost of revenue, for each of the succeeding fiscal years ending December 31 for finite-lived intangible assets that existed at September 30, 2016 (in thousands):

|                   |         |
|-------------------|---------|
| Remainder of 2016 | \$2,218 |
| 2017              | 7,420   |
| Total             | \$9,638 |

Sales and Marketing

|                     | Three Months Ended     |          | Nine Months Ended |           |   |
|---------------------|------------------------|----------|-------------------|-----------|---|
|                     | September 30,          |          | September 30,     |           |   |
|                     | 2016                   | 2015     | 2016              | 2015      |   |
|                     | (dollars in thousands) |          |                   |           |   |
| Sales and marketing | \$53,690               | \$53,255 | \$168,226         | \$150,659 |   |
| Percent of revenue  | 49.8                   | % 61.0   | % 53.6            | % 61.8    | % |

Sales and marketing expenses remained relatively consistent for the three months ended September 30, 2016 as compared to the same period in 2015. This was attributable to our continued efforts to optimize the efficiency of our existing sales teams. We assess our investments in new and existing markets strategically and we believe we have gained leverage through our operational excellence initiatives. As a percentage of revenue, sales and marketing expense decreased by 11 percentage points as we continued our efforts to strategically scale up our sales teams and their productivity.

Sales and marketing expenses increased \$17.6 million, or 12%, for the nine months ended September 30, 2016 as compared to the same period in 2015. The increase was attributable to the expansion of our sales force as well as increased sales commissions and increases in marketing programs to address additional opportunities in new and existing markets. Total sales and marketing headcount contributed to an increase in employee-related costs of \$16.1 million. In addition, we incurred increased costs associated with outsourced marketing programs of \$3.3 million. As a percentage of revenue, sales and marketing expense decreased by eight percentage points as we continued our efforts to strategically scale up our sales teams and their productivity.

## Research and Development

|                          | Three Months Ended     |          | Nine Months Ended |          |
|--------------------------|------------------------|----------|-------------------|----------|
|                          | September 30,          |          | September 30,     |          |
|                          | 2016                   | 2015     | 2016              | 2015     |
|                          | (dollars in thousands) |          |                   |          |
| Research and development | \$12,130               | \$10,457 | \$34,927          | \$30,207 |
| Percent of revenue       | 11.3                   | % 12.0   | % 11.1            | % 12.4   |

Research and development expenses increased by \$1.7 million, or 16%, for the three months ended September 30, 2016 as compared to the same period in 2015. The increase was principally due to an increase in research and development headcount to maintain and improve the functionality of our solutions. We continue to develop and release new products and new features within existing products. As a result, we incurred increased employee-related costs of \$1.3 million.

Research and development expenses increased by \$4.7 million, or 16%, for the nine months ended September 30, 2016 as compared to the same period in 2015. The increase was principally due to an increase in research and development headcount to maintain and improve the functionality of our solutions. We continue to develop and release new products and new features within existing products. As a result, we incurred increased employee-related costs of \$3.8 million.

We capitalize a portion of our software development costs related to the development and enhancements of our solutions, which are then amortized to cost of revenue. The timing of our capitalizable development and enhancement projects may affect the amount of development costs expensed in any given period. We capitalized \$5.6 million and \$4.4 million of software development costs and amortized \$3.5 million and \$2.3 million in the three months ended September 30, 2016 and 2015, respectively, and capitalized \$15.3 million and \$12.1 million and amortized \$9.5 million and \$6.5 million in the nine months ended September 30, 2016 and 2015, respectively.

## General and Administrative

|                            | Three Months Ended     |          | Nine Months Ended |          |
|----------------------------|------------------------|----------|-------------------|----------|
|                            | September 30,          |          | September 30,     |          |
|                            | 2016                   | 2015     | 2016              | 2015     |
|                            | (dollars in thousands) |          |                   |          |
| General and administrative | \$18,608               | \$13,194 | \$51,611          | \$36,545 |
| Percent of revenue         | 17.3                   | % 15.1   | % 16.4            | % 15.0   |

General and administrative expenses increased by \$5.4 million, or 41%, for the three months ended September 30, 2016 as compared to the same period in 2015. The increase was driven by higher costs to support our growing business.

General and administrative expenses increased by \$15.1 million, or 41%, for the nine months ended September 30, 2016 as compared to the same period in 2015. The increase was driven by higher costs to support our growing business.

## Amortization of certain acquired intangible assets

|  | Three Months Ended |        | Nine Months Ended |      |
|--|--------------------|--------|-------------------|------|
|  | September 30,      |        | September 30,     |      |
|  | 2016               | 2015   | 2016              | 2015 |
|  | (in thousands)     |        |                   |      |
| Amortization of certain acquired intangible assets | \$-150             | \$ 150 | \$ 450            |      |

Amortization of certain acquired intangible assets decreased by \$0.2 million, or 100%, for the three months ended September 30, 2016, as compared to the same period in 2015 due to the acquired intangible assets being fully amortized during the three months ended September 30, 2016. Amortization of certain acquired intangible assets

decreased by \$0.3 million, or 67%, for the nine months ended September 30, 2016, as compared to the same period in 2015 due to the acquired intangible assets being fully amortized during the nine months ended September 30, 2016.

## Other Income (Expense)

|                  | Three Months Ended    |                       | Nine Months Ended     |                       |
|------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                  | September 30,<br>2016 | September 30,<br>2015 | September 30,<br>2016 | September 30,<br>2015 |
|                  | (in thousands)        |                       |                       |                       |
| Interest income  | \$451                 | \$218                 | \$1,182               | \$590                 |
| Interest expense | (3,245 )              | (3,138 )              | (9,652 )              | (9,343 )              |
| Other, net       | 663                   | (66 )                 | 2,938                 | (3,257 )              |
| Total            | \$(2,131)             | \$(2,986)             | \$(5,532)             | \$(12,010)            |

Interest income for the three and nine months ended September 30, 2016 increased \$0.2 million and \$0.6 million, respectively, as compared to the same period in 2015 due to the increase in interest income earned on the purchase of investment securities net of purchased premium amortization. Interest expense for the three and nine months ended September 30, 2016 increased by \$0.1 million and \$0.3 million, respectively, as compared to the same period in 2015 due to an increase in interest expense for our convertible notes.

Other, net is primarily comprised of foreign exchange gains and losses related to transactions denominated in foreign currencies and foreign exchange gains and losses related to our intercompany loans and certain cash accounts. Foreign exchange gains and losses for the three and nine months ended September 30, 2016 and 2015, respectively, were primarily driven by fluctuations in the Euro and U.S. Dollar in relation to the British Pound.

## Income Tax Provision

|                      | Three Months Ended    |                       | Nine Months Ended     |                       |
|----------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                      | September 30,<br>2016 | September 30,<br>2015 | September 30,<br>2016 | September 30,<br>2015 |
|                      | (in thousands)        |                       |                       |                       |
| Income tax provision | \$(218)               | \$(132)               | \$(894 )              | \$(790 )              |

For the three and nine months ended September 30, 2016, we recorded an income tax provision related to certain foreign and state income taxes.

## Liquidity and Capital Resources

At September 30, 2016, our principal sources of liquidity were \$65.3 million of cash and cash equivalents, investments in marketable securities of \$243.7 million, and \$99.6 million of accounts receivable. In June 2013, we issued \$253 million of 1.5% convertible notes due July 1, 2018 (the "Notes") and concurrently entered into convertible notes hedges and separate warrant transactions. The Notes mature on July 1, 2018, unless earlier converted. We intend to use our cash for general corporate purposes, including potential future acquisitions or other transactions. Depending on certain growth opportunities, we may choose to accelerate investments in sales and marketing, research and development, technology and services, which may require the use of proceeds for such additional expansion and expenditures. Based on our current level of operations and anticipated growth, we believe our future cash flows from operating activities and existing cash and cash equivalents will provide adequate funds for our ongoing operations and general corporate purposes for at least the next twelve months. Our future capital requirements will depend on many factors, including our rate of revenue, billings growth and collections, the level of our sales and marketing efforts, the timing and extent of spending to support product development efforts and expansion into new territories, the timing of introductions of new services and enhancements to existing services, the timing of general and administrative expenses as we grow our administrative infrastructure, and the continuing market acceptance of our solution. To the extent that existing cash and cash from operations are not sufficient to fund our future activities, we may need to raise additional funds. Although we are not currently a party to any agreement or letter of intent with respect to potential investments in, or acquisitions of, complementary businesses, services or technologies, we may enter into these types of arrangements in the future, which could also require us to seek additional financing or utilize our cash resources.





The following table sets forth a summary of our cash flows for the periods indicated (in thousands):

|   | Nine<br>Months Ended<br>September 30, |           |
|---|---------------------------------------|-----------|
|   | 2016                                  | 2015      |
| Net cash provided by (used in) operating activities | \$1,718                               | \$(9,284) |
| Net cash used in investing activities               | (61,344)                              | (105,778) |
| Net cash provided by financing activities           | 17,737                                | 8,717     |

Our cash flows from operating activities are significantly influenced by our growth, ability to maintain our contractual billing and collection terms, and our investments in headcount and infrastructure to support anticipated growth. Given the seasonality and continued growth of our business, our cash flows from operations will vary from period to period. Cash provided by operating activities was \$1.7 million for the nine months ended September 30, 2016 compared to cash used in operating activities of \$9.3 million for the nine months ended September 30, 2015. The increase in operating cash flows was primarily due to a decrease in net loss compared to the prior period and an increase in non-cash adjustments to reconcile net loss to net cash provided by operations.

Our primary investing activities have consisted of investments, capital expenditures to develop our capitalized software as well as to purchase software, computer equipment, leasehold improvements, and furniture and fixtures in support of expanding our infrastructure and workforce. We invest our excess cash in investment securities. Since June 2014, we made multiple strategic investments in various privately-held companies. In November of 2014, we purchased the privately held company, Evolv Inc. As our business grows, we expect our investment activity to continue to increase.

Cash used in investing activities was \$61.3 million for the nine months ended September 30, 2016, compared to cash used in investing activities of \$105.8 million for the nine months ended September 30, 2015. The increase in investing cash flow was primarily due to the timing of maturities and purchases of our investments. As the investments mature and result in excess cash, we will purchase additional investments depending on our cash balance, cash requirements and investment opportunities. Additionally, our capital expenditures decreased in the nine months ended September 30, 2016, as we spent \$7.3 million to upgrade our data infrastructure in the nine months ended September 30, 2015.

Cash provided by financing activities was \$17.7 million for the nine months ended September 30, 2016, compared to \$8.7 million for the nine months ended September 30, 2015. The increase in financing cash flows was due to an increase in proceeds from employee stock awards, which includes proceeds from option exercises and cash received for the purchase of shares under our ESPP.

#### Contractual Obligations

There have been no material changes in contractual obligations from those disclosed in our Annual Report on Form 10-K filed with the SEC on February 26, 2016 except for the following: we (i) entered into various operating lease agreements with obligations of approximately \$0.3 million in 2016 and \$0.6 million in 2017; (ii) entered into a sponsorship agreement with a professional sports franchise with obligations of approximately \$2.7 million in 2017, \$0.7 million in 2018 and \$0.7 million in 2019; and (iii) amended an agreement to increase our contractual commitment with a third-party service provider by \$0.5 million in each of 2016 and 2017.

#### Off-Balance Sheet Arrangements

As part of our ongoing business, we do not have any relationships with other entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, that have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. We are therefore not exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in those types of relationships.



### ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

We have operations in the United States and internationally, and we are exposed to market risks in the ordinary course of our business. These risks primarily include interest rate, foreign exchange, inflation and counterparty risks, as well as risks relating to changes in the general economic conditions in the countries where we conduct business. To reduce certain of these risks, we monitor the financial condition of our large clients and limit credit exposure by principally collecting in advance and setting credit limits as we deem appropriate. In addition, our investment strategy has been to invest in financial instruments, including corporate bonds, U.S. treasury securities, agency securities, commercial paper and money market funds backed by United States Treasury Bills within the guidelines established under our investment policy. We also make strategic investments in privately-held companies in the development stage. To date, we have not used derivative instruments to mitigate the impact of our market risk exposures. We have also not used, nor do we intend to use, derivatives for trading or speculative purposes.

#### Interest Rate Risk

At September 30, 2016, we had cash and cash equivalents of \$65.3 million and investments of \$245.7 million, which primarily consisted of corporate bonds, U.S. treasury securities, agency securities, commercial paper, money market funds backed by United States Treasury Bills and other debt securities. The carrying amount of our cash equivalents reasonably approximates fair value due to the short maturities of these instruments.

The primary objectives of our investment activities are the preservation of capital, the fulfillment of liquidity needs and the fiduciary control of cash and investments. We do not enter into investments for trading or speculative purposes. Our investments are exposed to market risk due to fluctuations in interest rates, which may affect the fair market value of our investments. An increase of 50-basis points in interest rates would have resulted in a \$0.8 million reduction on the fair market value of our portfolio as of September 30, 2016. We therefore do not expect our operating results or cash flows to be materially affected by a sudden change in market interest rates.

We do not believe our cash equivalents, corporate bonds, U.S. treasury securities, agency securities and commercial paper have significant risk of default or illiquidity. While we believe these cash investments do not contain excessive risk, we cannot provide assurance that in the future our investments will not be subject to adverse changes in market value. In addition, we maintain significant amounts of cash and cash equivalents at one or more financial institutions that are in excess of federally insured limits. We cannot provide assurance that we will not experience losses on these deposits.

#### Foreign Currency Risk

We have foreign currency risks related to our revenue and operating expenses denominated in currencies other than the U.S. Dollar. Our historical revenue has primarily been denominated in U.S. Dollars, and a significant portion of our current revenue continues to be denominated in U.S. Dollars. However, we expect an increasing portion of our future revenue to be denominated in currencies other than the U.S. Dollar, primarily the Euro and British Pound. To a lesser extent, we also have revenue denominated in Australian Dollars, Brazilian Reals, Canadian Dollars, Indian Rupees, Japanese Yen, New Zealand Dollars, Singapore Dollars, South African Rand, and other foreign currencies. Our operating expenses are generally denominated in the currencies of the countries in which our operations are located, primarily the United States and, to a lesser extent, the United Kingdom, other European Union countries, Australia, Brazil, Canada, China, Hong Kong, India, Israel, Japan and New Zealand. Increases and decreases in our foreign-denominated revenue from movements in foreign exchange rates are often partially offset by the corresponding decreases or increases in our foreign-denominated operating expenses. Due to our legal structure, revenue and operating expenses denominated in currencies other than the U.S. Dollar primarily flow through our U.K. subsidiary, which has a functional currency of the British Pound. This legal structure results in a two-step currency exchange process wherein the currencies other than the British Pound are first converted into the British Pound and then British Pounds are translated into U.S. Dollars for our Consolidated Financial Statements. Our other income (expense) is also impacted by the re-measurement of U.S. Dollar denominated intercompany loans, cash accounts held by our overseas subsidiaries, accounts receivable denominated in foreign currencies and accounts payable denominated in foreign currencies.

As our international operations grow, our risks associated with fluctuation in currency rates will become greater, and we will continue to reassess our approach to managing this risk. In addition, currency fluctuations or a weakening

U.S. Dollar can increase the costs of our international expansion. To date, we have not entered into any foreign currency hedging contracts although we may do so in the future. The effect of an immediate 10% adverse change in foreign exchange rates on foreign-denominated accounts at September 30, 2016, including our intercompany loans with our subsidiaries, would result in a foreign currency loss of approximately \$8.6 million.

#### Inflation Risk

We do not believe that inflation has had a material effect on our business, financial condition or results of operations. Nonetheless, if our costs were to become subject to significant inflationary pressures, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could harm our business, financial condition and results of operations.

#### Counterparty Risk

Our financial statements are subject to counterparty credit risk, which we consider as part of the overall fair value measurement. We attempt to mitigate this risk through credit monitoring procedures.

### ITEM 4. Controls and Procedures

#### Evaluation of Disclosure Controls and Procedures

The term “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”), refers to controls and procedures that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms.

Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that such information is accumulated and communicated to a company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2016, the end of the period covered by this Quarterly Report on Form 10-Q. Based upon such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective as of such date.

#### Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the three months ended September 30, 2016 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II. OTHER INFORMATION

### ITEM 1. Legal Proceedings

From time to time, we are subject to various legal proceedings that arise in the normal course of our business activities. In addition, from time to time, third parties may assert intellectual property infringement claims against us in the form of letters and other forms of communication. As of the date of this Quarterly Report on Form 10-Q, we are not a party to any litigation the outcome of which, if determined adversely to us, would individually or in the aggregate be reasonably expected to have a material adverse effect on our results of operations, cash flows or financial position.

#### ITEM 1A. Risk Factors

The following risk factors and other information included in this Quarterly Report on Form 10-Q should be carefully considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we presently deem less significant may also impair our business operations. Please see page 17 of this Quarterly Report on Form 10-Q for a discussion of the forward-looking statements that are qualified by these risk factors. If any of the events or circumstances described in the following risk factors actually occurs, our business, operating results and financial condition could be materially adversely affected.

##### Risks Related to Our Business and Industry

We have a history of losses, and we cannot be certain that we will achieve or sustain profitability.

We have incurred losses since our inception. We experienced net losses of \$12.4 million, \$48.2 million, \$85.5 million, \$64.9 million, and \$40.4 million for the three and nine months ended September 30, 2016, and years ended December 31, 2015, 2014 and 2013, respectively. At September 30, 2016, our accumulated deficit was \$435.1 million and total stockholders' equity was \$22.8 million. We expect to continue to incur operating losses as a result of expenses associated with the continued development and expansion of our business. Our expenses include, among others, sales and marketing, research and development, consulting and support services and other costs relating to the development, marketing and sale and service of our solutions that may not generate revenue until later periods, if at all. Any failure to increase revenue or manage our cost structure as we implement initiatives to grow our business could prevent us from achieving or sustaining profitability. In addition, our ability to achieve profitability is subject to a number of the risks and uncertainties discussed below, many of which are beyond our control. We cannot be certain that we will be able to achieve or sustain profitability on a quarterly or annual basis.

Unfavorable conditions in our industry or the global economy, or reductions in information technology spending, could limit our ability to grow our business and negatively affect our operating results.

Our operating results may vary based on the impact of changes in our industry or the global economy on us or our clients. The revenue growth and potential profitability of our business depends on demand for enterprise application software and services generally and for human capital management solutions in particular. We sell our Enterprise and Mid-Market solution primarily to large, mid-sized and small business organizations whose businesses fluctuate based on general economic and business conditions. In addition, a portion of our revenue is attributable to the number of users of our solutions at each of our clients, which in turn is influenced by the employment and hiring patterns of our clients and potential clients. To the extent that economic uncertainty or weak economic conditions cause our clients and potential clients to freeze or reduce their headcount, demand for our solutions may be negatively affected.

Historically, economic downturns have resulted in overall reductions in spending on information technology and human capital management solutions as well as pressure from clients and potential clients for extended billing terms. If economic conditions deteriorate, our clients and potential clients may elect to decrease their information technology and human capital management budgets by deferring or reconsidering product purchases, which would limit our ability to grow our business and negatively affect our operating results.

Our financial results may fluctuate due to our long, variable and, therefore, unpredictable sales cycle and our focus on large and mid-market organizations.

We plan our expenses based on certain assumptions about the length and variability of our sales cycle. If our sales cycle becomes longer or more variable, our results may be adversely affected. Our sales cycle generally varies in duration from two to nine months and, in some cases, much longer depending on the size of the potential client.

Factors that may influence the length and variability of our sales cycle include among others:

- the need to educate potential clients about the uses and benefits of our solutions;
- the relatively long duration of the commitment clients make in their agreements with us;
- the discretionary nature of potential clients' purchasing and budget cycles and decisions;
- the competitive nature of potential clients' evaluation and purchasing processes;
- the lengthy purchasing approval processes of potential clients;
- the evolving functionality demands of potential clients;

fluctuations in the human capital management needs of potential clients; and  
announcements or planned introductions of new products by us or our competitors.

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The fluctuations that result from the length and variability of our sales cycle may be magnified by our focus on sales to large and mid-sized organizations. If we are unable to close an expected significant transaction with one or more of these companies in a particular period, or if an expected transaction is delayed until a subsequent period, our operating results, and in particular our billings, for that period, and for any future periods in which revenue from such transaction would otherwise have been recognized, may be adversely affected.

Our financial results may fluctuate due to other factors, including invoicing terms, some of which may be beyond our control.

There are a number of other factors that may cause our financial results to fluctuate from period to period, including among others:

- changes in billing cycles and the size of advance payments relative to overall contract value in client agreements;
- the extent to which new clients are attracted to our solutions to satisfy their human capital management needs;
- the timing and rate at which we sign agreements with new clients;
- our access to service providers when we outsource client service projects and our ability to manage the quality and completion of the related client implementations;
- the timing and duration of our client implementations, which is often outside of our direct control, and our ability to provide resources for client implementations and consulting projects;
- the extent to which we retain existing clients and satisfy their requirements;
- the extent to which existing clients renew their subscriptions to our solutions and the timing of those renewals;
- the extent to which existing clients purchase or discontinue the use of additional solutions and add or decrease the number of users;
- the extent to which our clients request enhancements to underlying features and functionality of our solutions and the timing of our delivery of these enhancements to our clients;
- the addition or loss of large clients, including through acquisitions or consolidations;
- the number and size of new clients, as well as the number and size of renewal clients in a particular period;
- the mix of clients among small, mid-sized and large organizations;
- changes in our pricing policies or those of our competitors;
- seasonal factors affecting demand for our solutions or potential clients' purchasing decisions;
- the financial condition and creditworthiness of our clients;
- the amount and timing of our operating expenses, including those related to the maintenance and expansion of our business, operations and infrastructure;
- the timing and success of our new product and service introductions;
- the timing of expenses of the development of new products and technologies, including enhancements to our solutions;
- our ability to exploit Big Data to drive increased demand for our products;
- continued strong demand for human capital management in the U.S. and globally;
- our ability to successfully integrate our operations with those of recently acquired privately-held companies;
- the success of current and new competitive products and services by our competitors;
- other changes in the competitive dynamics of our industry, including consolidation among competitors, clients or strategic partners;
- our ability to manage our existing business and future growth, including in terms of additional headcount, additional clients, incremental users and new geographic regions;
- expenses related to our network and data centers and the expansion of such networks and data centers;
- the effects of, and expenses associated with, acquisitions of third-party technologies or businesses and any potential future charges for impairment of goodwill resulting from those acquisitions;
- equity issuances, including as consideration in acquisitions or due to the conversion of our outstanding convertible notes;

fluctuations in foreign currency exchange rates, including any fluctuation caused by uncertainties relating to Brexit; general economic, industry and market conditions; and various factors related to disruptions in our SaaS hosting network infrastructure, defects in our solutions, privacy and data security, and exchange rate fluctuations, each of which is described elsewhere in these risk factors. In light of the foregoing factors, we believe that our financial results, including our revenue and deferred revenue levels, may vary significantly from period-to-period. As a result, period-to-period comparisons of our operating results may not be meaningful and should not be relied on as an indication of future performance. Forecasts of our business growth may prove to be inaccurate, and even if the markets in which we compete achieve the forecasted growth, we cannot assure you our business will grow at similar rates, or at all. Our forecasts are subject to significant uncertainty and are based on assumptions and estimates which may not prove to be accurate. These assumptions and estimates include the timing and value of agreements with our customers, variability in the service delivery periods for our customers, impact of foreign currency exchange rate fluctuations, and expected growth in our market. Our assumptions and estimates related to our business growth, including the performance of our core business and emerging businesses and the demand for our solutions in the United States, Europe, Japan and other regions, may prove to be inaccurate. Even if the markets experience the forecasted growth, we may not grow our business at similar rates, or at all. Our growth is subject to many factors, including our success in implementing our business strategy, which is subject to many risks and uncertainties. Even if demand for human capital management products and services increases generally, there is no guarantee that demand for SaaS solutions like ours will increase to a corresponding degree. The widespread adoption of our solutions depends not only on strong demand for human capital management products and services generally, but also for products and services delivered via a SaaS business model in particular. There are still a significant number of organizations that have adopted no human capital management functions at all, and it is unclear whether such organizations will ever adopt such functions and, if they do, whether they will desire SaaS human capital management solutions like ours. As a result, we cannot assure you that our SaaS human capital management solutions will achieve and sustain the high level of market acceptance that is critical for the success of our business. Our business depends substantially on clients renewing their agreements with us, purchasing additional solutions from us or adding additional users. Any decline in our clients renewing their agreements, purchasing additional products or adding additional users would harm our future operating results. In order for us to improve our operating results, it is important that our clients renew their agreements with us when the initial contract term expires and also purchase additional products or add additional users. Our clients have no obligation to renew their subscriptions after the initial subscription period, and we cannot assure you that our clients will renew their subscriptions at the same or a higher level of service, if at all. Every year, some of our clients elect not to renew their agreements with us. Moreover, certain of our clients have the right to cancel their agreements for convenience, subject to certain notice requirements and, in some cases, early termination fees. Our client renewal rates may decline or fluctuate as a result of a number of factors, including their satisfaction or dissatisfaction with our solutions, our pricing, the prices of competing products or services, mergers and acquisitions affecting our client base, reduced hiring by our clients or reductions in our clients' spending levels. If our clients do not renew their subscriptions, renew on less favorable terms, fail to purchase additional products, or fail to add new users, our revenue may decline, and our operating results may be harmed. 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 human capital management software is highly competitive, rapidly evolving and fragmented. Many of our competitors and potential competitors are larger and have greater brand name recognition, much longer operating histories, larger marketing budgets and significantly greater resources than we do. In addition, with the introduction of new technologies and market entrants, we expect competition to intensify in the future. If we fail to compete effectively, our business will be harmed. Some of our principal competitors offer their products or services at a lower price, which has resulted in pricing pressures. Similarly, some competitors offer different billing terms, which has resulted in pressures on our billing terms. If we are unable to maintain our pricing levels and billing terms, our

operating results could be negatively impacted. In addition, pricing pressures and increased competition generally could result in reduced sales, reduced margins, losses or the failure of our solution to achieve or maintain more widespread market acceptance, any of which could harm our business.

We face competition from paper-based processes and desktop software tools. We also face competition from custom-built software that is designed to support the needs of a single organization, as well as from third-party talent and human resource application providers. These software vendors include, without limitation, Halogen Software, Inc., International Business Machines Corporation, Lumesse AS, Oracle Corporation, Peoplefluent, Inc., Saba Software, Inc., SAP America, Inc., Skillsoft Corp., and Workday, Inc. In addition, some of the parties with which we maintain business alliances offer or may offer products or services that compete with our products or services. Many of our competitors are able to devote greater resources to the development, promotion and sale of their products and services. In addition, many of our competitors have established marketing relationships, access to larger client bases and major distribution agreements with consultants, system integrators and distributors. Moreover, many software vendors can bundle human resource products or offer such products at a lower price as part of a larger product sale. In addition, some competitors may offer software that addresses one or a limited number of human capital management functions at a lower price point or with greater depth than our solutions. 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 client requirements. Further, some potential clients, particularly large enterprises, may elect to develop their own internal solutions. For all of these reasons, we may not be able to compete successfully against our current and future competitors.

Mergers of or other strategic transactions by our competitors could weaken our competitive position or reduce our revenue.

If one or more of our competitors were to merge, acquire or partner with another of our competitors, the change in the competitive landscape could adversely affect our ability to compete effectively. For example, in February 2012, SAP America, Inc. acquired SuccessFactors, Inc.; in April 2012, Oracle Corporation acquired Taleo Corporation; in August 2012, International Business Machines Corporation acquired Kenexa, Inc.; and in October 2014, Skillsoft Corp. acquired SumTotal Systems, Inc. Our competitors may also establish or strengthen cooperative relationships with our current or future strategic distributors, systems integrators, HR outsourcers, payroll services companies, third-party consulting firms or other parties with whom we have relationships, thereby limiting our ability to promote our solutions and limiting the number of consultants available to implement our solutions. Disruptions in our business caused by these events could reduce our revenue.

Our business and operations are experiencing rapid growth and organizational change. If we fail to effectively manage such growth and change in a manner that preserves the key aspects of our corporate culture, our business and operating results could be harmed.

We have experienced, and may continue to experience, rapid growth and organizational change, which has placed, and may continue to place, significant demands on our management, operational and financial resources. For example, our headcount has grown from 1,606 employees on September 30, 2015 to 1,788 employees on September 30, 2016. In addition, we have international offices in Australia, Brazil, France, Germany, Hong Kong, India, Israel, Japan, Netherlands, New Zealand, Spain, Sweden and the United Kingdom. We may continue to expand our international operations into other countries in the future, either organically or through acquisitions. We have also experienced significant growth in the number of users, transactions and data that our SaaS hosting infrastructure supports. Finally, our organizational structure is becoming more complex as we improve our operational, financial and management controls as well as our reporting systems and procedures. We will require significant capital expenditures and the allocation of valuable management resources to grow and change in these areas without undermining our corporate culture of rapid innovation, teamwork and attention to client success that has been central to our growth so far. If we fail to manage our anticipated growth and change in a manner that preserves the key aspects of our corporate culture, the quality of our solutions may suffer, which could negatively affect our brand and reputation and harm our ability to retain and attract clients.

For a detailed discussion of the risks related to our ability to expand our business internationally, manage growth in our SaaS hosting network infrastructure, and expand parts of our organization to implement improved operational, financial and management controls and reporting systems, see the risk factors titled “—As a public company, we are obligated to maintain proper and effective internal control over financial reporting. If our internal control over financial reporting is ineffective, our financial reporting may not be accurate, complete and timely, and our auditors

may be unable to attest to its effectiveness when required, thus adversely affecting investor confidence in our company.” and “—We currently have a limited number of international offices and are expanding our international operations. Additionally, we do not have substantial experience in all international markets and may not achieve the results that we expect.”

We may acquire other companies or technologies, which could divert our management's attention, result in additional dilution to our stockholders or otherwise disrupt our operations and harm our operating results.

In April 2012, we acquired Sonar Limited, a SaaS talent management solution provider serving small businesses, and in November 2014, we acquired Evolv Inc., a machine learning and data science platform provider. In the future, we may seek to acquire or invest in other businesses, products or technologies that we believe could complement or expand our existing solutions, enhance our technical capabilities or otherwise offer growth opportunities. The pursuit of potential acquisitions may divert the attention of management and cause us to incur various expenses in identifying, investigating and pursuing suitable acquisitions, whether or not they are ultimately consummated.

Other than our acquisitions of Sonar Limited and Evolv Inc., we do not have any experience in acquiring other businesses. We may not be able to successfully integrate the personnel, operations and technologies of any businesses that we have acquired or may acquire in the future or effectively manage the combined business following the acquisition. We may also not achieve the anticipated benefits from other acquired businesses due to a number of factors, including:

- unanticipated costs or liabilities associated with the acquisition;
- incurrence of acquisition-related costs;
- diversion of management's attention from other business concerns;
- harm to our existing relationships with distributors and clients as a result of the acquisition;
- the potential loss of key employees;
- exposure to claims and disputes by third parties, including intellectual property claims and disputes;
- the use of resources that are needed in other parts of our business; and
- the use of substantial portions of our available cash to consummate the acquisition.

In addition, a significant portion of the purchase price of companies we acquire may be allocated to acquired goodwill, which must be assessed for impairment at least annually, or to intangible assets, which are assessed for impairment upon certain triggering events. In the future, if our acquisitions do not yield expected returns, we may be required to take charges to our operating results based on this impairment assessment process, which could harm our operating results.

Acquisitions could also result in dilutive issuances of equity securities or the incurrence of debt, which could adversely affect our operating results. For example, in our acquisition of Sonar Limited, we issued an aggregate of 46,694 shares of our common stock. In addition, if an acquired business fails to meet our expectations, our operating results, business and financial condition may suffer.

As a public company, we are obligated to maintain proper and effective internal control over financial reporting. If our internal control over financial reporting is ineffective, our financial reporting may not be accurate, complete and timely, and our auditors may be unable to attest to its effectiveness when required, thus adversely affecting investor confidence in our company.

We are required, pursuant to Section 404 of the Sarbanes-Oxley Act, to furnish a report by management on, among other things, the effectiveness of our internal control over financial reporting. Our auditors also need to audit the effectiveness of our internal control over financial reporting. These assessments need to include disclosure of any material weaknesses in our internal control over financial reporting.

We have incurred and continue to incur significant costs assessing our system of internal control over financial reporting and processing documentation necessary to perform the evaluation needed to comply with Section 404. We may discover, and may not be able to remediate, future significant deficiencies or material weaknesses, or we may be unable to complete our evaluation, testing or any required remediation in a timely fashion. Failure of our internal control over financial reporting to be effective could cause our financial reporting to be inaccurate, incomplete or delayed. Moreover, even if there is no inaccuracy, incompleteness or delay of reporting results, if we identify one or more material weaknesses in our internal control over financial reporting, we will be unable to assert, and our auditors will be unable to affirm, that our internal control is effective, in which case investors may lose confidence in the accuracy and completeness of our financial reports, which could have a material adverse effect on the price of our common stock.



Our systems collect, access, use and store personal and other client proprietary information. As a result, we are subject to security risks and are required to invest significant resources to prevent or correct problems caused by security breaches. If a security breach occurs, our reputation could be harmed, our business may suffer, and we could incur significant liability.

Our human capital management solutions involve the storage and transmission of clients' proprietary and confidential information over the Internet (including public networks), and security breaches, unauthorized access, unauthorized usage, viruses or similar breaches or disruptions could result in loss of this information, damage to our reputation, early termination of our contracts, litigation, regulatory investigations or other liabilities. In addition, errors in the storage or transmission of such information could compromise the security of that information. If our security measures are breached as a result of third-party action, employee error, malfeasance or otherwise and, as a result, someone obtains unauthorized access to client data, our reputation will be damaged, our business may suffer and we could incur significant liability. Advances in computer capabilities, new discoveries in the field of cryptography or other events or developments could result in compromises or breaches of our security systems and the data stored in these systems. Because there is a time lag associated with developing adequate protections against such new developments and techniques, unauthorized access or sabotage of our systems and the information processed in connection with our business may result. If an actual or perceived security breach occurs, the market perception of our security measures could be harmed and we could lose sales and clients. Any violations of privacy or information security could result in the loss of business, litigation and regulatory investigations and penalties that could damage our reputation and adversely impact our operating results and financial condition, including our ability to make required reporting and disclosures as a public company. Moreover, if a high profile security breach occurs with respect to another SaaS provider, our clients and potential clients may lose trust in the security of the SaaS business model generally, which could adversely impact our ability to retain existing clients or attract new ones.

Any significant disruption in our SaaS hosting network infrastructure could harm our reputation, require us to provide credits or refunds, result in early terminations of client agreements or a loss of clients, and adversely affect our business.

Our SaaS hosting network infrastructure is a critical part of our business operations. Our clients access our human capital management solutions through a standard web browser and depend on us for fast and reliable access to our solutions. Our software is proprietary, and we rely on third-party data center hosting facilities and the expertise of members of our engineering and software development teams for the continued performance of our solutions. We have experienced, and may in the future experience, disruptions in our computing and communications infrastructure. Factors that may cause such disruptions that may harm our reputation include:

- human error;
- security breaches;
- telecommunications outages from third-party providers;
- computer viruses;
- acts of terrorism, sabotage or other intentional acts of vandalism, including cyber attacks;
- unforeseen interruption or damages experienced in moving hardware to a new location;
- fire, earthquake, flood and other natural disasters; and
- power loss.

Although we generally back up our client databases hourly, store our data in more than one geographically distinct location at least weekly and perform real-time mirroring of data to disaster recovery locations, we do not currently offer immediate access to disaster recovery locations in the event of a disaster or major outage. Thus, in the event of any of the factors described above, or certain other failures of our computing infrastructure, clients may not be able to access their data for 24 hours or more. There is a remote chance that client data from recent transactions may be permanently lost or otherwise compromised. Moreover, some of our agreements include performance guarantees and service level standards that obligate us to provide credits, or refunds or termination rights in the event of a significant disruption in our SaaS hosting network infrastructure or other technical problems that relate to the functionality or design of our solutions.





We rely on various third-party consulting firms to deliver consulting services to our clients, and if these firms fail to deliver these services effectively, or if we are unable to maintain existing relationships or enter into new relationships, it could impact the timing of the recognition of the revenue associated with such services.

We rely on various third-party consulting firms to assist us in the successful implementation of our solutions and to optimize our clients' use of our solutions during the terms of their engagements. If these firms fail to deliver these services to our customers in an effective and timely manner, we may suffer reputational harm and our result of operations may be adversely impacted. Also, unfavorable global economic conditions may hurt our providers, making them less effective or causing them to modify or cancel their relationships with us. If we are unable to maintain our existing relationships or enter into new ones, we would have to devote substantially more resources to delivering our consulting services, which could impact the timing of the recognition of the revenue associated with such services.

We rely on third-party computer hardware and software that may be difficult to replace or could cause errors or failures of our service.

In addition to the software we develop, we rely on computer hardware, purchased or leased, and software licensed from third parties in order to deliver our solutions. This hardware and software may not continue to be available on commercially reasonable terms, if at all. Any loss of the right to use any of this hardware or software could result in delays in our ability to provide our solutions until equivalent technology is either developed by us or, if available, identified, obtained and integrated. In addition, errors or defects in third-party hardware or software used in our solutions could result in errors or a failure of our solutions, which could harm our business.

Defects in our solutions could affect our reputation, result in significant costs to us, and impair our ability to sell our solutions and related services.

Defects in our solutions could adversely affect our reputation, result in significant costs to us, and impair our ability to sell our solutions in the future. The costs incurred in correcting any solution defects may be substantial and could adversely affect our operating results. Although we continually test our solutions for defects and work with clients through our client support organization to identify and correct errors, defects in our solutions are likely to occur in the future. Any defects that cause interruptions to the availability of our solutions could result in:

- lost or delayed market acceptance and sales of our solutions;
- early termination of client agreements or loss of clients;
- credits or refunds to clients;
- product liability suits against us;
- diversion of development resources;
- injury to our reputation; and
- increased maintenance and warranty costs.

While our client agreements typically contain limitations and disclaimers that purport to limit our liability for damages related to defects in our solutions, such limitations and disclaimers may not be enforced by a court or other tribunal or otherwise effectively protect us from such claims.

If we fail to manage our SaaS hosting network infrastructure capacity, our existing clients may experience service outages and our new clients may experience delays in the deployment of our human capital management solutions. We have experienced significant growth in the number of users, transactions and data that our hosting infrastructure supports. We seek to maintain sufficient excess capacity in our SaaS hosting network infrastructure to meet the needs of all of our clients. We also seek to maintain excess capacity to facilitate the rapid provision of new client deployments and the expansion of existing client deployments. However, the provision of new hosting infrastructure requires significant lead time. If we do not accurately predict our infrastructure capacity requirements, our existing clients may experience service outages that may subject us to financial penalties, financial liabilities and client losses. If our hosting infrastructure capacity fails to keep pace with increased sales, clients may experience delays as we seek to obtain additional capacity, which could harm our reputation and adversely affect our revenue growth.



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

We anticipate that we will continue to depend on various third-party relationships in order to grow our business. In addition to growing our indirect sales channels, we intend to pursue additional relationships with other third parties, such as technology and content providers and implementation consultants. Identifying, negotiating and documenting relationships with third parties require significant time and resources, as does integrating third-party content and technology. Our agreements with distributors and providers of technology, content and consulting services are typically non-exclusive and do not prohibit them from working with our competitors or from offering competing services. Our competitors may be effective in providing incentives to third parties to favor their products or services or to prevent or reduce subscriptions to our solutions. In addition, these distributors and providers may not perform as expected under our agreements, and we have had, and may in the future have, disagreements or disputes with such distributors and providers, which could negatively affect our brand and reputation. A global economic slowdown could also adversely affect the businesses of our distributors, and it is possible that they may not be able to devote the resources we expect to our relationships with such distributors.

If we are unsuccessful in establishing or maintaining our relationships with these third parties, our ability to compete in the marketplace or to grow our revenue could be impaired and our operating results could suffer. Even if we are successful, we cannot assure you that these relationships will result in improved operating results.

Failure to effectively expand our direct sales teams and develop and expand our indirect sales channel will impede our growth.

We will need to continue to expand our sales and marketing infrastructure in order to grow our client base and our business. We plan to significantly expand our direct sales teams and engage additional third-party distributors, both domestically and internationally. Identifying, recruiting and training these people and entities will require significant time, expense and attention. Our business will be seriously harmed and our financial resources will be wasted if our efforts to expand our direct and indirect sales channels do not generate a corresponding increase in revenue. In particular, if we are unable to hire, develop and retain talented sales personnel or if our new direct sales personnel are unable to achieve expected productivity levels in a reasonable period of time, we may not be able to significantly increase our revenue and grow our business.

If we fail to retain key employees and recruit qualified technical and sales personnel, our business could be harmed. We believe that our success depends on the continued employment of our senior management and other key employees, such as our chief executive officer. In addition, because our future success is dependent on our ability to continue to enhance and introduce new software and services, we are heavily dependent on our ability to attract and retain qualified engineers with the requisite education, background and industry experience. As we expand our business, our continued success will also depend, in part, on our ability to attract and retain qualified sales, marketing and operational personnel capable of supporting a larger and more diverse client base. The loss of the services of a significant number of our engineers or sales people could be disruptive to our development efforts or business relationships. In addition, if any of our key employees joins a competitor or decides to otherwise compete with us, we may experience a material disruption of our operations and development plans, which may cause us to lose clients or increase operating expenses as the attention of our remaining senior managers is diverted to recruit replacements for the departed key employees.

In cases where we are asked by clients to deploy our solutions on their behalf, failure to effectively manage such client deployments by us or our third-party service providers could adversely impact our business.

Clients have the option of implementing our solutions themselves or relying on us to do so on their behalf. In cases where we are asked to deploy a solution for a client, we need to have a substantial understanding of such client's business so that we can configure the solution in a manner that complements its existing business processes and integrates the solution into its existing systems. It may be difficult for us to manage the timeliness of these deployments and the allocation of personnel and resources by us or our clients. In certain situations, we also work with third-party service providers in the deployment of our solutions, and we may experience difficulties managing such third parties. Failure to successfully manage client deployments by us or our third-party service providers could harm our reputation and cause us to lose existing clients, face potential client disputes or limit the rate at which new clients purchase our solutions.



Because of how we recognize revenue, a significant downturn in our business may not be immediately reflected in our operating results.

Generally, we recognize revenue from subscription agreements monthly over the terms of these agreements, which is typically three years for our Enterprise and Mid-Market solution. As a result, a significant portion of the revenue we report in each quarter is generated from client agreements entered into during previous periods. Consequently, a decline in new subscriptions in any one quarter may not significantly impact our revenue and financial performance in that quarter, but will negatively affect our revenue, or rate of revenue growth, and financial performance in future quarters.

In addition, if subscription agreements expire and are not renewed in the same quarter, our revenue and financial performance in that quarter and subsequent quarters will be negatively affected. However, the revenue impact may not be immediately reflected in our operating results to the extent there is an offsetting increase in revenue from services contracts performed in that same quarter.

Finally, we may be unable to adjust our fixed costs in response to reduced revenue. Accordingly, the effect of significant declines in sales and market acceptance of our solutions may not be reflected in our short-term operating results.

Because we generally recognize subscription revenue from our clients over the terms of their agreements but incur most costs associated with generating such agreements upfront, rapid growth in our client base may put downward pressure on our operating income in the short term.

The expenses associated with generating client agreements are generally incurred up front but the resulting subscription revenue is generally recognized over the life of the agreements; therefore, increased growth in the number of our clients will result in our recognition of more costs than revenue during the early periods covered by such agreements, even in cases where the agreements are expected to be profitable for us over their full terms.

Certain of our operating results and financial metrics are difficult to predict as a result of seasonality.

We have historically experienced seasonality in terms of when we enter into client agreements for our solutions. We sign a significantly higher percentage of agreements with new clients, and renewal agreements with existing clients, in the fourth quarter of each year and a significant portion of these agreements are signed during the last month, and with respect to each quarter, often the last two weeks, of the quarter. This seasonality is reflected to a much lesser extent, and sometimes is not immediately apparent, in our revenue, due to the fact that we generally recognize subscription revenue over the term of the client agreement, which is generally three years. We expect this seasonality to continue, which may cause fluctuations in certain of our operating results and financial metrics, and thus difficulties in predictability.

Integrated, comprehensive SaaS solutions such as ours represent a relatively recent approach to addressing organizations' human capital management challenges, and we may be forced to change the prices we charge for our solutions, or the pricing model upon which they are based, as the market for these types of solutions evolves.

Providing organizations with applications to address their human capital management challenges through integrated, comprehensive SaaS solutions is a developing market. The market for these solutions is therefore still evolving, and competitive dynamics may cause pricing levels, as well as pricing models generally, to change, as the market matures and as existing and new market participants introduce new types of solutions and different approaches to enable organizations to address their human capital management needs. As a result, we may be forced to reduce the prices we charge for our solutions or the pricing model on which they are based, and may be unable to renew existing client agreements or enter into new client agreements at the same prices and upon the same terms that we have historically, which could have a material adverse effect on our revenue, gross margin and other operating results.

Existing or future laws and regulations relating to privacy or data security could increase the cost of our solutions and subject us or our clients to litigation, regulatory investigations and other potential liabilities.

Our human capital management solutions enable our clients to collect, manage and store a wide range of data related to every phase of the employee performance and management cycle. The United States and various state governments have adopted or proposed limitations on the collection, distribution and use of personal information. Several foreign jurisdictions, including the European Union, or EU, and the United Kingdom, China, Korea, Japan, Singapore, Australia and India, have adopted legislation (including directives or regulations) that increase or change the

requirements governing data collection and storage in these jurisdictions. These laws and regulations are complex and change frequently, with new laws and regulations proposed frequently and existing laws and regulations subject to different and conflicting interpretations. For example, the EU recently adopted a general data protection regulation, effective in May 2018, that will supersede current EU data protection legislation, impose more stringent EU data protection requirements, and provide for greater penalties for noncompliance. In

addition, following a referendum on June 23, 2016 on the United Kingdom's membership in the EU, the outcome of which was a vote in favor of leaving the EU, it is expected that the United Kingdom government will shortly commence negotiations in connection with any exit from the EU (often referred to as "Brexit"). The outcome of the referendum has created uncertainty with regard to the regulation of data protection in the United Kingdom. In particular, it is unclear whether the United Kingdom will enact the general data protection regulation, and how data transfers to and from the United Kingdom will be regulated.

If our privacy or data security measures fail to comply with current or future laws and regulations, we may be subject to litigation, regulatory investigations or other liabilities, as well as negative publicity and a loss of business. Any of these matters could materially adversely affect our business, financial condition or operational results. Moreover, if future laws and regulations limit our clients' ability to use and share employee data or our ability to store, process and share data with our clients over the Internet, demand for our solutions could decrease, our costs could increase, and our operating results and financial condition could be harmed.

In particular, with regard to transfers of personal data, as such term is used in the EU, we historically have relied upon adherence to the U.S. Department of Commerce's Safe Harbor Privacy Principles and compliance with the U.S.-EU and U.S.-Swiss Safe Harbor Frameworks. The U.S.-EU Safe Harbor Framework, which, together with the U.S.-Swiss Safe Harbor Framework, established the means for legitimizing the transfer of personal data by U.S. companies from the European Economic Area, or EEA, to the U.S., was invalidated in October 2015 by a decision of the European Court of Justice, or the ECJ Ruling. As a result of the ECJ Ruling, the Swiss data protection regulator has questioned the status of the U.S.-Swiss Safe Harbor Framework. In light of these events, we may find it necessary or desirable to make other changes to our personal data handling. U.S. and EU authorities reached a political agreement on February 2, 2016 regarding a new potential means for legitimizing personal data transfers from the EEA to the United States, the EU-U.S. Privacy Shield, but it is unclear whether the EU-U.S. Privacy Shield will be formally implemented and whether the EU-U.S. Privacy Shield will serve as an appropriate means for us to legitimize personal data transfers from the EEA to the United States. In addition, the EU-U.S. Privacy Shield may be challenged by national regulators or private parties. We may be unsuccessful in establishing legitimate means for our transfer of personal data from the EEA or otherwise responding to the ECJ Ruling, and we may experience reluctance or refusal by current or prospective European customers to use our solutions. Our response to the ECJ Ruling may cause us to assume additional liabilities or incur additional expenses for implementing compliance requirements, and the ECJ Ruling and our response could adversely affect our billings. We and those transferring personal data to us may face a risk of enforcement actions by data protection authorities in the EEA until the time, if any, that personal data transfers to us and by us from the EEA are legitimized under applicable EU data protection law.

Evolving regulation of the Internet, changes in the infrastructure underlying the Internet, or interruptions in Internet access may adversely affect our financial condition by increasing our expenditures and causing client dissatisfaction. As Internet commerce continues to evolve, regulation by federal, state or foreign agencies may increase. We are particularly sensitive to these risks because the Internet is a critical component of our business model. In addition, taxation of services provided over the Internet or other charges for accessing the Internet may be imposed by government agencies or private organizations. Legislation has been proposed that may impact the way that Internet service providers treat Internet traffic. The outcome of such proposals is uncertain but certain outcomes may negatively increase our operating costs or otherwise impact our business. Any regulation imposing greater fees for Internet use or restricting information exchanged over the Internet could result in a decline in the use of the Internet and the viability of Internet-based services, which could harm our business.

In addition, the rapid and continual growth of traffic on the Internet has resulted at times in slow connection and download speeds among Internet users. Our business expansion may be harmed if the Internet infrastructure cannot handle our clients' demands or if hosting capacity becomes insufficient. If our clients become frustrated with the speed at which they can utilize our solutions over the Internet, our clients may discontinue the use of our human capital management solutions and choose not to renew their contracts with us. Further, the performance of the Internet has also been adversely affected by viruses, hacking, phishing attacks, denial of service attacks, and other similar malicious programs, which have resulted in a variety of Internet outages, interruptions, and other delays. These service interruptions could diminish the overall attractiveness of our solutions to existing and potential users and could



cause demand for our solutions to suffer.

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We currently have a limited number of international offices and are expanding our international operations. Additionally, we do not have substantial experience in all international markets and may not achieve the results that we expect.

We currently have international offices in Australia, Brazil, France, Germany, Hong Kong, India, Israel, Japan, Netherlands, New Zealand, Spain, Sweden and the United Kingdom, and we may expand our international operations into other countries in the future. International operations involve a variety of risks, including:

- unexpected changes in regulatory requirements, taxes, trade laws, tariffs, export quotas, custom duties or other trade restrictions;
- differing labor regulations;
- regulations relating to data security and the unauthorized use of, or access to, commercial and personal information;
- potential penalties or other adverse consequences for violations of anti-corruption, anti-bribery and other similar laws and regulations, including the U.S. Foreign Corrupt Practices Act and the U.K. Bribery Act;
- greater difficulty in supporting and localizing our products;
- unrest and/or changes in a specific country's or region's political or economic conditions;
- challenges inherent in efficiently managing an increased number of employees over large geographic distances, including the need to implement appropriate systems, controls, policies, benefits and compliance programs;
- currency exchange rate fluctuations, including any fluctuations caused by uncertainties relating to Brexit;
- limited or unfavorable intellectual property protection; and
- restrictions on repatriation of earnings.

We have less significant experience in marketing, selling and supporting our products and services abroad than domestically. Our less significant experience in operating our business internationally increases the risk that any potential future expansion efforts that we may undertake will not be successful. In addition, it may take us longer to build our presence in international markets. If we invest substantial time and resources to expand our international operations and are unable to do so successfully and in a timely manner, our business and operating results will suffer. We are also monitoring developments related to Brexit, which could have significant implications for our business. The political and economic instability created by the United Kingdom's vote to leave the EU has caused and may continue to cause significant volatility in global financial markets and the value of the Great British Pound currency or other currencies, including the Euro. Depending on the terms reached regarding any exit from the EU, it is possible that there may be adverse practical and/or operational implications on our business.

If we fail to develop our brand cost-effectively, our business may suffer.

We believe that developing and maintaining awareness of the Cornerstone OnDemand brand in a cost-effective manner is critical to achieving widespread acceptance of our existing and future solutions and is an important element in attracting new clients. Furthermore, we believe that the importance of brand recognition will increase as competition in our market increases. Successful promotion of our brand will depend largely on the effectiveness of our marketing efforts and on our ability to provide reliable and useful services at competitive prices. In the past, our efforts to build our brand have involved significant expenses. Brand promotion activities may not yield increased revenue, and even if they do, any increased revenue may not offset the expenses we incurred in building our brand. In addition, the Cornerstone OnDemand Foundation shares our company name and any negative perceptions of any kind about the Cornerstone OnDemand Foundation could adversely affect our brand and reputation. If we fail to successfully promote and maintain our brand, or incur substantial expenses in an unsuccessful attempt to promote and maintain our brand, we may fail to attract enough new clients or retain our existing clients to the extent necessary to realize a sufficient return on our brand-building efforts, and our business could suffer.

We face risks associated with our sales to governmental entities.

The risks associated with doing business with governmental entities include, but are not limited to, the following:

- Selling to governmental entities can be more competitive, expensive and time consuming than selling to private entities;
- Governmental entities may have significant leverage in negotiations, thereby enabling such entities to demand contract terms that differ from what we generally agree to in our standard agreements, including, for example, most

favored nation clauses and terms allowing contract termination for convenience;

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Government demand and payment for our solutions may be influenced by public sector budgetary cycles and funding authorizations, with funding reductions or delays having an adverse impact on public sector demand for our solutions; and

Government contracts are generally subject to audits and investigations, which we have no experience with, including termination of contracts, refund of a portion of fees received, forfeiture of profits, suspension of payments, fines and suspensions or debarment from future government business.

While our experience dealing with governmental entities has so far been limited, to the extent that we become more reliant on contracts with government clients in the future, our exposure to such risks could increase, which, in turn, could adversely impact our business.

If for any reason we are not able to develop enhancements and new features, keep pace with technological developments or respond to future disruptive technologies, our business will be harmed.

Our future success will depend on our ability to adapt and innovate. To attract new clients and increase revenue from existing clients, we will need to enhance and improve our existing solutions and introduce new features. The success of any enhancement or new feature depends on several factors, including timely completion, introduction and market acceptance. If we are unable to enhance our existing products to meet client needs or successfully develop or acquire new features or products, or if such new features or products fail to be successful, our business and operating results will be adversely affected.

In addition, because our solutions are designed to operate on a variety of network, hardware and software platforms using Internet tools and protocols, we will need to continuously modify and enhance our solutions to keep pace with changes in internet-related hardware, software, communication, browser and database technologies. If we are unable to respond in a timely and cost-effective manner to these rapid technological developments, our solutions may become less marketable and less competitive or obsolete, and our operating results may be negatively impacted.

Finally, our ability to grow is subject to the risk of future disruptive technologies. If new technologies emerge that are able to deliver human capital management solutions at lower prices, more efficiently or more conveniently, such technologies could adversely impact our ability to compete.

We may require additional capital to support business growth, and this capital may not be available on acceptable terms, if at all.

We intend to continue to make investments to support our business growth and may seek additional funds to respond to business challenges, including the need to develop new features or enhance our existing solutions, improve our operating infrastructure or acquire complementary businesses and technologies. Accordingly, we may need to engage in additional equity or debt financings to secure additional funds. If we raise additional funds through issuances of equity or debt securities, our existing stockholders could suffer significant dilution, and any new equity securities we issue could have rights, preferences and privileges superior to those of holders of our common stock. Any debt financing secured by us in the future could involve restrictive covenants relating to our capital raising activities and other financial and operational matters, which may make it more difficult for us to obtain additional capital and to pursue business opportunities, including potential acquisitions. In addition, we may not be able to obtain additional financing on terms favorable to us, if at all. If we are unable to obtain adequate financing or financing on terms satisfactory to us, when we require it, our ability to continue to support our business growth and to respond to business challenges could be significantly impaired.

Our ability to make scheduled payments of the principal of, to pay interest on or to refinance our indebtedness, including our convertible notes, depends on our future performance, which is subject to economic, financial, competitive and other factors beyond our control. Our business may not generate cash flow from operations in the future sufficient to satisfy our obligations under the notes and any future indebtedness we may incur and to make necessary capital expenditures. If we are unable to generate such cash flow, we may be required to adopt one or more alternatives, such as reducing or delaying investments or capital expenditures, selling assets, refinancing or obtaining additional equity capital on terms that may be onerous or highly dilutive. Our ability to refinance the notes or future indebtedness will depend on the capital markets and our financial condition at such time. We may not be able to engage in any of these activities or engage in these activities on desirable terms, which could result in a default on the notes or future indebtedness.



The conditional conversion feature of the notes, if triggered, may adversely affect our financial condition and operating results.

In the event the conditional conversion feature of the notes is triggered, holders of notes will be entitled to convert the notes at any time during specified periods at their option. If one or more holders elect to convert their notes, we would be required to settle a portion of our conversion obligation through the payment of cash, which could adversely affect our liquidity. In addition, even if holders do not elect to convert their notes, we could be required under applicable accounting rules to reclassify all or a portion of the outstanding principal of the notes as a current rather than long-term liability, which would result in a material reduction of our net working capital.

The accounting method for our convertible debt securities that may be settled in cash, such as the notes, may have a material effect on our reported financial results.

In May 2008, the Financial Accounting Standards Board, or FASB, issued FASB Staff Position No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement), which has subsequently been codified as Accounting Standards Codification 470-20, Debt with Conversion and Other Options, which we refer to as ASC 470-20. Under ASC 470-20, an entity must separately account for the liability and equity components of the convertible debt instruments (such as the notes) that may be settled entirely or partially in cash upon conversion in a manner that reflects the issuer's economic interest cost. The effect of ASC 470-20 on the accounting for the notes is that the equity component is required to be included in the additional paid-in capital section of stockholders' equity on our consolidated balance sheet, and the value of the equity component would be treated as original issue discount for purposes of accounting for the debt component of the notes. As a result, we will be required to record a greater amount of non-cash interest expense in current periods presented as a result of the amortization of the discounted carrying value of the notes to their face amount over the term of the notes. We will report lower net income (or greater net loss) in our financial results because ASC 470-20 will require interest to include both the current period's amortization of the debt discount and the instrument's coupon interest, which could adversely affect our reported or future financial results, the market price of our common stock and the trading price of the notes.

In addition, convertible debt instruments (such as the notes) that may be settled entirely or partly in cash are currently accounted for utilizing the treasury stock method, the effect of which is that the shares issuable upon conversion of the notes are not included in the calculation of diluted earnings per share except to the extent that the conversion value of the notes exceeds their principal amount. Under the treasury stock method, for diluted earnings per share purposes, the transaction is accounted for as if the number of shares of common stock that would be necessary to settle such excess, if we elected to settle such excess in shares, are issued. We cannot be sure that the accounting standards in the future will continue to permit the use of the treasury stock method. If we are unable to use the treasury stock method in accounting for the shares issuable upon conversion of the notes, then our diluted earnings per share would be adversely affected.

If we fail to adequately protect our proprietary rights, our competitive advantage and brand could be impaired and we may lose valuable assets, generate reduced revenue and incur costly litigation to protect our rights.

Our success is dependent, in part, upon protecting our proprietary technology. We rely on a combination of patents, copyrights, trademarks, service marks, trade secret laws and contractual restrictions to establish and protect our proprietary rights in our products and services. However, the steps we take to protect our intellectual property may be inadequate. We will not be able to protect our intellectual property if we are unable to enforce our rights or if we do not detect unauthorized use of our intellectual property. Despite our precautions, it may be possible for unauthorized third parties to copy our products and use information that we regard as proprietary to create products and services that compete with ours. Some license provisions protecting against unauthorized use, copying, transfer and disclosure of our licensed products may be unenforceable under the laws of certain jurisdictions and foreign countries. Further, the laws of some countries do not protect proprietary rights to the same extent as the laws of the United States. To the extent we expand our international activities, our exposure to unauthorized copying and use of our products and proprietary information may increase.

We enter into confidentiality and invention assignment agreements with our employees and consultants and enter into confidentiality agreements with the parties with whom we have strategic relationships and business alliances. These

agreements may not be effective in controlling access to and distribution of our products and proprietary information. Further, these agreements do not prevent our competitors from independently developing technologies that are substantially equivalent or superior to our solutions. Litigation brought to protect and enforce our intellectual property rights could be costly, time consuming and distracting to management and could result in the impairment or loss of portions of our intellectual property. If we fail to secure, protect and enforce our intellectual property rights, we may lose valuable assets, generate reduced revenue and incur costly litigation to protect our rights, which could seriously harm our brand and adversely impact our business.

We may be sued by third parties for alleged infringement of their proprietary rights or may find it necessary to enter into licensing arrangements with third parties to settle or forestall such claims, either of which could have a material adverse effect on our operating results and financial condition.

There is considerable patent and other intellectual property development activity in our industry. Our success depends in part upon our not infringing the intellectual property rights of others. However, our competitors, as well as a number of other entities and individuals, may own or claim to own intellectual property relating to our industry or, in some cases, our technology or products. From time to time, such third parties may claim that we are infringing their intellectual property rights, and we may actually be found to be infringing such rights. Moreover, we may be subject to claims of infringement with respect to technology that we acquire or license from third parties. The risk that we could be subject to infringement claims is increasing as the number of products and companies competing with our solutions grows. Any claims or litigation could require the commitment of substantial time and resources and, if successfully asserted against us, could require that we pay substantial damages or ongoing royalty or licensing payments, indemnify our clients, distributors or other third parties, modify or discontinue the sale of our products, or refund fees, any of which would deplete our resources and adversely impact our business. We have in the past obtained, and may in the future obtain, licenses from third parties to forestall or settle potential claims that our products and technology infringe the intellectual property rights of others. Discussions and negotiations with such third parties, whether successful or unsuccessful, could result in substantial costs and the diversion of management resources, either of which could seriously harm our business.

Indemnity provisions in various agreements potentially expose us to substantial liability for intellectual property infringement and other losses.

Our agreements with clients and other third parties may include indemnification provisions under which we agree to indemnify them for losses suffered or incurred as a result of claims of intellectual property infringement, damages caused by us to property or persons, or other liabilities relating to or arising from our products, services or other contractual obligations. The term of these indemnity provisions generally survives termination or expiration of the applicable agreement. Large indemnity payments could harm our business, operating results and financial condition. From time to time, we are requested by clients to indemnify them for breach of confidentiality with respect to personal data. Although we normally do not agree to, or contractually limit our liability with respect to, such requests, the existence of such a dispute with a client may have adverse effects on our client relationships and reputation.

We use open source software in our products, which could subject us to litigation or other actions.

We use open source software in our products and may use more open source software in the future. From time to time, there have been claims challenging the ownership of open source software against companies that incorporate open source software into their products. As a result, we could be subject to suits by parties claiming ownership of what we believe to be open source software. Litigation could be costly for us to defend, have a negative effect on our operating results and financial condition or require us to devote additional research and development resources to change our products. In addition, if we were to combine our proprietary software products with open source software in a certain manner, we could, under certain of the open source licenses, be required to release the source code of our proprietary software products. If we inappropriately use open source software, we may be required to re-engineer our products, discontinue the sale of our products or take other remedial actions.

We are subject to governmental export and import controls that could impair our ability to compete in international markets due to licensing requirements and subject us to liability if we are not in full compliance with applicable laws. Our solutions are subject to export controls, including the Commerce Department's Export Administration Regulations and various economic and trade sanctions regulations established by the Treasury Department's Office of Foreign Assets Controls, and exports of our solutions must be made in compliance with these laws. If we fail to comply with these U.S. export control laws and import laws, including U.S. Customs regulations, we and certain of our employees could be subject to substantial civil or criminal penalties, including the possible loss of export or import privileges; fines, which may be imposed on us and responsible employees or managers; and, in extreme cases, the incarceration of responsible employees or managers. In addition, if our distributors fail to obtain appropriate import, export or re-export licenses or authorizations, we may also be adversely affected through reputational harm and penalties. Obtaining the necessary authorizations, including any required license, for a particular sale may be time-consuming



and is not guaranteed, and may result in the delay or loss of sales opportunities. Furthermore, the U.S. export control laws and economic sanctions laws prohibit the shipment of certain products and services to U.S. embargoed or sanctioned countries, governments and persons. Even though we take precautions to prevent our solutions from being shipped or provided to U.S. sanctions targets, our solutions and services could be shipped to those targets or provided by our distributors despite such precautions. Any such shipment could have negative consequences, including government investigations, penalties and reputational harm. In addition, various countries regulate the import of

certain encryption technology, including through import permitting or licensing requirements, and have enacted laws that could limit our ability to distribute our solutions or could limit our clients' ability to implement our solutions in those countries. Changes to our solutions or changes in export and import regulations may create delays in the introduction and sale of our solutions in international markets, prevent our clients with international operations from deploying our solutions or, in some cases, prevent the export or import of our solutions to certain countries, governments or persons altogether. Any change in export or import regulations, economic sanctions or related laws, shift in the enforcement or scope of existing regulations, or change in the countries, governments, persons or technologies targeted by such regulations, could result in decreased use of our solutions, or in our decreased ability to export or sell our solutions to existing or potential clients with international operations. Any decreased use of our solutions or limitation on our ability to export or sell our solutions would likely adversely affect our business, financial condition and operating results.

Fluctuations in the exchange rate of foreign currencies could result in foreign currency gains and losses.

We currently have foreign sales denominated in Australian Dollars, Brazilian Reals, Canadian Dollars, Chinese Yuan, Euros, British Pounds, Indian Rupees, Japanese Yen, New Zealand Dollars, and South African Rand and may in the future have sales denominated in the currencies of additional countries. In addition, we incur a portion of our operating expenses in British Pounds and Euros and, to a much lesser extent, in Australian Dollars, Brazilian Reals, Canadian Dollars, Chinese Yuan, Danish Krone, Hong Kong Dollars, Indian Rupees, Israeli New Shekels, Japanese Yen, New Zealand Dollars, Norwegian Kroner, Polish Zloty, Singapore Dollars, Swedish Krona and Swiss Franc. Further, our overseas subsidiaries' results are also impacted by exchange rates affecting the carrying value of U.S. Dollar denominated intercompany loans with us. Fluctuations in the exchange rates of these foreign currencies, including any fluctuations caused by uncertainties relating to Brexit, may negatively impact our business, financial condition and operating results. Due to our legal structure, any fluctuations in the exchange rates of the Great British Pound may be particularly impactful. We have not previously engaged in foreign currency hedging. If we decide to hedge our foreign currency exposure, we may not be able to completely eliminate the impact of fluctuations in the exchange rates.

Changes in financial accounting standards or practices may cause adverse, unexpected financial reporting fluctuations and affect our reported operating results.

A change in accounting standards or practices can have a significant effect on our reported results and may even affect our reporting of transactions completed before the change is effective. New accounting pronouncements and varying interpretations of accounting pronouncements have occurred and may occur in the future. Changes to existing rules or the questioning of current practices may adversely affect our reported financial results or the way we conduct our business.

Our investment portfolio is subject to general credit, liquidity, counterparty, market and interest rate risks, any of which could impair the market value of our investments and harm our financial results.

At September 30, 2016, we had \$65.3 million in cash and cash equivalents and \$243.7 million in short-term and long-term investments in marketable securities, consisting of corporate bonds, money market funds backed by United States Treasury Bills, U.S. treasury securities and agency securities. Although we follow an established investment policy and set of guidelines to manage our investment portfolio, our investments are subject to general credit, liquidity, counterparty, market and interest rate risks, which have been exacerbated by the recent financial and credit crisis, rising bankruptcy filings in the United States, and the ongoing debt-ceiling debate.

Because the market value of fixed-rate debt securities may be adversely impacted by a rise in interest rates, our future investment income may fall short of expectations if interest rates rise. In addition, we may suffer losses if we are forced to sell securities that have experienced a decline in market value because of changes in interest rates. Currently, we do not use financial derivatives to hedge our interest rate exposure.

The fair value of our investments may change significantly due to events and conditions in the credit and capital markets. Any investment securities that we hold, or the issuers of such securities, could be subject to review for possible downgrade. Any downgrade in these credit ratings may result in an additional decline in the estimated fair value of our investments. Changes in the various assumptions used to value these securities and any increase in the perceived market risk associated with such investments may also result in a decline in estimated fair value.

In the event of adverse conditions in the credit and capital markets, and to the extent we make future investments, our investment portfolio may be impacted, and we could determine that some or all of our investments experienced an other-than-temporary decline in fair value, requiring impairment, which could adversely impact our financial position and operating results.

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We may invest in companies for strategic reasons and may not realize a return on our investments.

In November 2013, we launched a strategic initiative created to invest in, advise and collaborate with promising cloud startups building innovative business applications that support the continued expansion of our market reach. From time to time we may make direct investments in privately held companies. For example, since 2014, we have made strategic investments in multiple privately-held companies. The privately held companies in which we may invest are considered inherently risky. The technologies and products these companies have under development are typically in the early stages and may never materialize, which could result in a loss of all or a substantial part of our initial investment in these companies. The evaluation of privately held companies is based on information that we request from these companies, which is not subject to the same disclosure regulations as U.S. publicly traded companies, and as such, the basis for these evaluations is subject to the timing and accuracy of the data received from these companies.

To the extent that our pre-tax income or loss becomes relatively modest, our ability to conclude that a control deficiency is not a material weakness or that an accounting error does not require a restatement could be adversely affected.

Under the Sarbanes-Oxley Act of 2002, our management is required to assess the impact of control deficiencies based upon both quantitative and qualitative factors, and depending upon that analysis, we classify such identified deficiencies as either a control deficiency, significant deficiency or a material weakness. One element of our analysis of the significance of any control deficiency is its actual or potential financial impact. This assessment will vary depending on our level of pre-tax income or loss. For example, a smaller pre-tax income or loss will increase the likelihood of a quantitative assessment of a control deficiency as a significant deficiency or material weakness.

To the extent that our pre-tax income or loss is relatively small, if management or our independent registered public accountants identify an error in our interim or annual financial statements, it is more likely that such an error may be determined to be a material weakness or be considered a material error that could, depending upon the complete quantitative and qualitative analysis, result in our having to restate previously issued financial statements.

#### Risks Related to Tax Issues

We are a multinational organization faced with increasingly complex tax issues in many jurisdictions, and we could be obligated to pay additional taxes in various jurisdictions.

As a multinational organization, we are subject to taxation in several jurisdictions around the world with increasingly complex tax laws, the application of which can be uncertain. The amount of taxes we pay in these jurisdictions could increase substantially as a result of changes in the applicable tax principles, including increased tax rates, new tax laws or revised interpretations of existing tax laws and precedents, which could have a material adverse effect on our liquidity and operating results. In addition, the authorities in these jurisdictions could review our tax returns and impose additional tax, interest and penalties, and the authorities could claim that various withholding requirements apply to us or our subsidiaries or assert that benefits of tax treaties are not available to us or our subsidiaries, any of which could have a material impact on us and our operating results. If we are selected for future examinations that uncover incorrect tax positions, we could be subject to additional taxes, interest, and penalties.

Taxing authorities could reallocate our taxable income among our subsidiaries, which could increase our consolidated tax liability.

We conduct operations worldwide through subsidiaries in various tax jurisdictions pursuant to transfer pricing arrangements between our subsidiaries. If two or more affiliated companies are located in different countries, the tax laws or regulations of each country generally will require that transfer prices be the same as those between unrelated companies dealing at arms' length and that contemporaneous documentation is maintained to support the transfer prices. While we believe that we operate in compliance with applicable transfer pricing laws and intend to continue to do so, our transfer pricing procedures are not binding on applicable tax authorities. If tax authorities in any of these countries were to successfully challenge our transfer prices as not reflecting arm's length transactions, they could require us to adjust our transfer prices and thereby reallocate our income to reflect these revised transfer prices, which could result in a higher tax liability to us. In addition, if the country from which the income is reallocated does not agree with the reallocation, both countries could tax the same income, resulting in double taxation. If tax authorities were to allocate income to a higher tax jurisdiction, subject our income to double taxation or assess interest and

penalties, it would increase our consolidated tax liability, which could adversely affect our financial condition, operating results and cash flows.

Our ability to use net operating loss carryforwards to reduce future tax payments may be limited if we experience a change in ownership, or if taxable income does not reach sufficient levels.

Under Section 382 of the Internal Revenue Code of 1986, as amended, if a corporation undergoes an “ownership change” (generally defined as a greater than 50% change (by value) in its equity ownership over a three year period), the corporation’s ability to use its pre-change net operating loss carryforwards and other pre-change tax attributes (such as research tax credits) to offset its post-change income may be limited. We may experience ownership changes in the future and subsequent shifts in our stock ownership. As a result, we may be limited in the portion of net operating loss carryforwards that we can use in the future to offset taxable income for U.S. Federal income tax purposes.

#### Risks Related to Ownership of our Common Stock

The trading price of our common stock may be volatile.

The trading price of our common stock has at times been volatile and could continue to be subject to significant fluctuations in response to various factors, some of which are beyond our control. In addition, the stock market in general, and the market for technology companies in particular, has experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of the companies operating in such markets. The market price of our common stock may be similarly volatile, and investors in our common stock may experience a decrease in the value of their shares, including as a result of factors unrelated to our operating performance and prospects. The market price of our common stock could be subject to wide fluctuations in response to a number of factors, including:

- our operating performance and the performance of other similar companies;
- the financial or non-financial metric projections we provide to the public, including the failure of the projections to meet the expectations of securities analysts or investors, and any changes in these projections or our failure to meet or exceed these projections;
- the overall performance of the equity markets;
- developments with respect to intellectual property rights;
- publication of unfavorable research reports about us or our industry or withdrawal of research coverage by securities analysts;
- speculation in the press or investment community;
- the size of our public float;
- natural disasters or terrorist acts;
- announcements by us or our competitors of significant contracts, new technologies, acquisitions, commercial relationships, joint ventures or capital commitments; and
- global economic, legal and regulatory factors unrelated to our performance.

In addition, in the past, following periods of volatility in the overall market and the market price of a particular company’s securities, securities class action litigation has often been initiated against these companies. This litigation, if initiated against us, could result in substantial costs and a diversion of our management’s attention and resources.

If securities or industry analysts do not publish research or publish misleading or unfavorable research about our business, the market price of our common stock and trading volume could decline.

The trading market for our common stock depends in part on the research and reports that securities or industry analysts publish about us, our business or our market. If one or more of the analysts who covers us downgrade our common stock or publish incorrect or unfavorable research about our business, the market price of our common stock would likely decline. In addition, if one or more of these analysts cease coverage of our company or fail to publish reports on us regularly, demand for our common stock could decrease, which could cause the market price of our stock or trading volume to decline.

The issuance of additional stock in connection with acquisitions, our stock incentive plans or otherwise will dilute all other stockholdings.

Our certificate of incorporation authorizes us to issue up to 1,000,000,000 shares of common stock and up to 50,000,000 shares of preferred stock with such rights and preferences as may be determined by our board of directors. Subject to compliance with applicable rules and regulations, we may issue all of these shares that are not already

outstanding without any action or approval by our stockholders. We intend to continue to evaluate strategic acquisitions in the future. We may pay for such acquisitions, partly or in full, through the issuance of additional equity. Any issuance of shares in connection with our acquisitions, the exercise of stock options, the vesting of restricted stock units or otherwise would dilute the percentage ownership held by existing investors.

Conversion of our convertible notes may dilute the ownership interest of existing stockholders, including holders who had previously converted their notes, or may otherwise depress the price of our common stock.

The conversion of some or all of our convertible notes will dilute the ownership interests of existing stockholders to the extent we deliver shares upon conversion of any of the notes. Any sales in the public market of our common stock issuable upon such conversion could adversely affect prevailing market prices of our common stock. In addition, the existence of the notes may encourage short selling by market participants because the conversion of the notes could be used to satisfy short positions, or anticipated conversion of the notes into shares of our common stock could depress the price of our common stock.

We do not expect to declare any dividends in the foreseeable future.

We do not anticipate declaring any cash dividends to holders of our common stock in the foreseeable future.

Consequently, investors may need to sell all or part of their holdings of our common stock after price appreciation, which may never occur, as the only way to realize any future gains on their investment. Investors seeking cash dividends should not purchase our common stock.

Anti-takeover provisions in our charter documents and Delaware law may delay or prevent an acquisition of our company.

Our certificate of incorporation, our bylaws and Delaware law contain provisions that may have the effect of delaying or preventing a change in control of us or changes in our management. Our certificate of incorporation and our bylaws include provisions that:

- authorize “blank check” preferred stock, which could be issued by the board without stockholder approval and may contain voting, liquidation, dividend and other rights superior to our common stock;
- create a classified board of directors whose members serve staggered three-year terms;
- specify that special meetings of our stockholders can be called only by our board of directors, the chairperson of the board, the chief executive officer or the president;
- establish an advance notice procedure for stockholder approvals to be brought before an annual meeting of our stockholders, including proposed nominations of persons for election to our board of directors;
- provide that our directors may be removed only for cause;
- provide that vacancies on our board of directors may be filled only by a majority of directors then in office, even though less than a quorum;
- specify that no stockholder is permitted to cumulate votes at any election of directors; and
- require supermajority votes of the holders of our common stock to amend specified provisions of our charter documents.

These provisions, alone or together, could delay or prevent hostile takeovers and changes in control or changes in our management.

In addition, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which limits the ability of stockholders owning in excess of 15% of our outstanding voting stock to merge or combine with us.

Any provision of our certificate of incorporation, our bylaws or Delaware law that has the effect of delaying or deterring a change in control could limit the opportunity for our stockholders to receive a premium for their shares of our common stock, and could also affect the price that some investors are willing to pay for our common stock.

## ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

Not applicable.

## ITEM 3. Defaults Upon Senior Securities

Not applicable.

## ITEM 4. Mine Safety Disclosures

Not applicable.



ITEM 5. Other Information

Not applicable.

ITEM 6. Exhibits

See the Exhibit Index immediately following the signature page of this Quarterly Report on Form 10-Q, which is incorporated herein by reference.

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SIGNATURE

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

Cornerstone OnDemand, Inc.  
(Registrant)

/s/ Brian L. Swartz  
Brian L. Swartz  
Chief Financial Officer  
(Duly Authorized Officer and Principal Financial and Accounting Officer)  
Date: November 3, 2016

EXHIBIT INDEX

| Exhibit Number | Exhibit Description  | Incorporated by Reference |                              |
|----------------|--|---------------------------|------------------------------|
|                |  | Form No.                  | File No. Exhibit Filing Date |
| 31.1           | Certification of the Chief Executive Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.   |                           |                              |
| 31.2           | Certification of the Chief Financial Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.   |                           |                              |
| 32.1†          | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002. |                           |                              |
| 32.2†          | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002. |                           |                              |
| 101.INS†       | XBRL Instance Document   |                           |                              |
| 101.SCH†       | XBRL Taxonomy Extension Schema Document  |                           |                              |
| 101.CAL†       | XBRL Taxonomy Extension Calculation Linkbase Document  |                           |                              |
| 101.DEF†       | XBRL Taxonomy Extension Definition Linkbase Document   |                           |                              |
| 101.LAB†       | XBRL Taxonomy Extension Label Linkbase Document  |                           |                              |
| 101.PRE†       | XBRL Taxonomy Extension Presentation Linkbase Document   |                           |                              |

\*Indicates a management contract or compensatory plan or arrangement

The certifications attached as Exhibit 32.1 and 32.2 that accompany this Quarterly Report on Form 10-Q are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference into any filing of Cornerstone OnDemand, Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Quarterly Report on Form 10-Q, irrespective of any general incorporation language contained in such filing.

†† The financial information contained in these XBRL documents is unaudited.