

Zendesk, Inc.
Form 10-Q
November 05, 2018
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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, 2018

OR

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

For the transition period from to

Commission File Number: 001-36456

ZENDESK, INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware	26-4411091
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1019 Market Street	94103
San Francisco, CA	
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (415) 418-7506

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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer <input checked="" type="checkbox"/>	Accelerated filer
Non-accelerated filer <input type="checkbox"/> (do not check if a smaller reporting company)	Smaller reporting company
	Emerging growth company

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

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Exchange Act.

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

As of October 31, 2018, there were 107,041,554 shares of the registrant's common stock outstanding.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

- our future financial performance, including our revenue, cost of revenue, gross profit, operating expenses, ability to generate positive cash flow, and ability to achieve and maintain profitability;
- the sufficiency of our cash and cash equivalents and marketable securities to meet our liquidity needs;
- our ability to attract and retain customers to use our products, and our ability to optimize the pricing for such products;
- the evolution of technology affecting our products, services, and markets;
- our ability to innovate and provide a superior customer experience;
- our ability to successfully expand in our existing markets and into new markets;
- the attraction and retention of qualified employees and key personnel;
- worldwide economic conditions and their impact on information technology spending;
- our ability to effectively manage our growth and future expenses;
- our ability to introduce and market new products and to integrate such products into our infrastructure;
- our ability to maintain, protect, and enhance our intellectual property;
- our ability to comply with modified or new laws and regulations applying to our business, including privacy and data security regulations;
- our ability to securely maintain customer data;
- our ability to service the interest on our convertible notes and repay such notes, if required;
- our ability to successfully integrate people, products, technology and services following completion of acquisitions;
- our ability to maintain and enhance our brand; and
- the increased expenses and administrative workload associated with being a public company.

We caution you that the foregoing list does not contain all of the forward-looking statements made in this Quarterly Report on Form 10-Q.

You should not rely upon forward-looking statements as predictions of future events. We have based the forward-looking statements contained in this Quarterly Report on Form 10-Q primarily on our current expectations and projections about future events and trends that we believe may affect our business, financial condition, operating results, and prospects. The outcome of the events described in these forward-looking statements is subject to risks, uncertainties, and other factors described in the section titled “Risk Factors” and elsewhere in this Quarterly Report on Form 10-Q. Moreover, we operate in a very competitive and rapidly changing environment. New risks and uncertainties emerge from time to time, and it is not possible for us to predict all risks and uncertainties that could have an impact on the forward-looking statements contained in this Quarterly Report on Form 10-Q. We cannot assure you that the results, events, and circumstances reflected in the forward-looking statements will be achieved or occur, and actual results, events, or circumstances could differ materially from those described in the forward-looking statements.

The forward-looking statements made in this Quarterly Report on Form 10-Q relate only to events as of the date on which the statements are made. We undertake no obligation to update any forward-looking statements made in this Quarterly Report on Form 10-Q to reflect events or circumstances after the date of this Quarterly Report on Form 10-Q or to reflect new information or the occurrence of unanticipated events, except as required by law. We may not actually achieve the plans, intentions, or expectations disclosed in our forward-looking statements and you should not place undue reliance on our forward-looking statements. Our forward-looking statements do not reflect the potential

impact of any future acquisitions, mergers, dispositions, joint ventures, or investments we may make.

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

ZENDESK, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value and shares)

	September 30, 2018 (Unaudited)	December 31, 2017 * As adjusted
Assets		
Current assets:		
Cash and cash equivalents	\$ 157,158	\$ 109,370
Marketable securities	293,598	137,576
Accounts receivable, net of allowance for doubtful accounts of \$2,862 and \$1,252 as of September 30, 2018 and December 31, 2017, respectively	82,935	57,096
Deferred costs	21,183	15,771
Prepaid expenses and other current assets	34,287	24,165
Total current assets	589,161	343,978
Marketable securities, noncurrent	360,350	97,447
Property and equipment, net	72,335	59,157
Deferred costs, noncurrent	22,175	15,395
Goodwill and intangible assets, net	148,886	67,034
Other assets	11,157	8,359
Total assets	\$ 1,204,064	\$ 591,370
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 29,270	\$ 5,307
Accrued liabilities	38,699	21,876
Accrued compensation and related benefits	39,158	29,017
Deferred revenue	222,936	173,147
Total current liabilities	330,063	229,347
Convertible senior notes, net	452,075	—
Deferred revenue, noncurrent	2,551	1,213
Other liabilities	14,598	6,626
Total liabilities	799,287	237,186
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Preferred stock	—	—
Common stock	1,066	1,031
Additional paid-in capital	905,386	753,568
Accumulated other comprehensive loss	(5,797)	(2,372)
Accumulated deficit	(495,878)	(398,043)
Total stockholders' equity	404,777	354,184
Total liabilities and stockholders' equity	\$ 1,204,064	\$ 591,370

* See Note 1 for a summary of adjustments.

See Notes to Condensed Consolidated Financial Statements.

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ZENDESK, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2017	2017	2018	2017
	*As	*As	*As	*As
	adjusted	adjusted	adjusted	adjusted
Revenue	\$154,828	\$112,265	\$426,501	\$308,249
Cost of revenue (1)	46,992	33,693	130,207	92,463
Gross profit	107,836	78,572	296,294	215,786
Operating expenses (1):				
Research and development	40,410	29,358	115,118	84,512
Sales and marketing	74,270	54,383	208,778	151,064
General and administrative	27,357	21,398	73,809	59,503
Total operating expenses	142,037	105,139	397,705	295,079
Operating loss	(34,201)	(26,567)	(101,411)	(79,293)
Other income (expense), net:				
Interest income	4,561	923	9,906	2,463
Interest expense	(6,375)	—	(13,427)	—
Other expense, net	(463)	(304)	(194)	(1,118)
Total other income (expense), net	(2,277)	619	(3,715)	1,345
Loss before benefit from income taxes	(36,478)	(25,948)	(105,126)	(77,948)
Benefit from income taxes	(2,334)	(133)	(7,291)	(785)
Net loss	\$(34,144)	\$(25,815)	\$(97,835)	\$(77,163)
Net loss per share, basic and diluted	\$(0.32)	\$(0.26)	\$(0.93)	\$(0.78)
Weighted-average shares used to compute net loss per share, basic and diluted	106,143	100,659	104,954	99,203

(1) Includes share-based compensation expense as follows:

	Three Months		Nine Months	
	Ended		Ended	
	September 30,		September 30,	
	2017	2017	2017	2017
	* As	* As	* As	* As
	adjusted	adjusted	adjusted	adjusted
Cost of revenue	\$3,929	\$2,408	\$10,500	\$6,668
Research and development	10,677	7,776	30,436	22,274
Sales and marketing	10,261	6,573	27,447	17,981
General and administrative	6,579	5,619	18,198	15,502

* See Note 1 for a summary of adjustments.

See Notes to Condensed Consolidated Financial Statements.

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ZENDESK, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(In thousands)

(Unaudited)

	Three Months Ended September 30, 2017		Nine Months Ended September 30, 2017	
	2018	* As adjusted	2018	* As adjusted
Net loss	\$(34,144)	\$(25,815)	\$(97,835)	\$(77,163)
Other comprehensive gain (loss), before tax:				
Net unrealized gain (loss) on available-for-sale investments	(50)	80	(673)	213
Foreign currency translation gain (loss)	—	—	(12)	824
Net unrealized gain (loss) on derivative instruments	418	344	(3,456)	3,692
Other comprehensive gain (loss), before tax	368	424	(4,141)	4,729
Tax effect	(366)	(156)	716	(1,737)
Other comprehensive gain (loss), net of tax	2	268	(3,425)	2,992
Comprehensive loss	\$(34,142)	\$(25,547)	\$(101,260)	\$(74,171)

* See Note 1 for a summary of adjustments.

See Notes to Condensed Consolidated Financial Statements.

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ZENDESK, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2017	2018
		* As adjusted
Cash flows from operating activities		
Net loss	\$(97,835)	\$(77,163)
Adjustments to reconcile net loss to net cash provided by operating activities		
Depreciation and amortization	27,193	24,263
Share-based compensation	86,581	62,425
Amortization of deferred costs	15,124	10,332
Amortization of debt discount and issuance costs	12,665	—
Other	2,865	381
Changes in operating assets and liabilities:		
Accounts receivable	(26,721)	(15,039)
Prepaid expenses and other current assets	(10,167)	(5,116)
Deferred costs	(26,716)	(15,595)
Other assets and liabilities	(8,026)	(5,323)
Accounts payable	20,607	7,237
Accrued liabilities	7,073	6,843
Accrued compensation and related benefits	2,487	1,503
Deferred revenue	50,552	30,174
Net cash provided by operating activities	55,682	24,922
Cash flows from investing activities		
Purchases of property and equipment	(27,132)	(13,334)
Internal-use software development costs	(5,550)	(5,237)
Purchases of marketable securities	(591,426)	(135,279)
Proceeds from maturities of marketable securities	131,819	88,960
Proceeds from sales of marketable securities	40,775	28,144
Cash paid for the acquisition of Outbound, net of cash acquired	—	(16,470)
Cash paid for the acquisition of FutureSimple, net of cash acquired	(79,363)	—
Net cash used in investing activities	(530,877)	(53,216)
Cash flows from financing activities		
Proceeds from issuance of convertible senior notes, net of issuance costs paid of \$13,561	561,439	—
Purchase of capped call related to convertible senior notes	(63,940)	—
Proceeds from exercises of employee stock options	13,254	18,550
Proceeds from employee stock purchase plan	15,999	10,980
Other	(3,807)	(2,415)
Net cash provided by financing activities	522,945	27,115
Effect of exchange rate changes on cash, cash equivalents and restricted cash	(55)	288
Net increase (decrease) in cash, cash equivalents and restricted cash	47,695	(891)
Cash, cash equivalents and restricted cash at beginning of period	110,888	95,062
Cash, cash equivalents and restricted cash at end of period	\$158,583	\$94,171

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Reconciliation of cash, cash equivalents and restricted cash to condensed consolidated balance sheets

Cash and cash equivalents	\$157,158	\$92,603
Restricted cash included in prepaid expenses and other current assets	826	920
Restricted cash included in other assets	599	648
Total cash, cash equivalents and restricted cash	\$158,583	\$94,171

Supplemental cash flow data

Cash paid for income taxes and interest	\$3,468	\$1,532
Non-cash investing and financing activities		
Balance of property and equipment in accounts payable and accrued expenses	\$5,680	\$1,384
Property and equipment acquired through tenant improvement allowances	\$5,435	\$437
Share-based compensation capitalized in internal-use software development costs	\$1,986	\$1,984
Share-based compensation capitalized in deferred costs	\$602	\$380
Vesting of early exercised stock options	\$—	\$317

*See Note 1 for a summary of adjustments.

See Notes to Condensed Consolidated Financial Statements.

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ZENDESK, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Overview and Basis of Presentation

Company and Background

Zendesk was founded in Denmark in 2007 and reincorporated in Delaware in April 2009.

We are a software development company that provides software as a service, or SaaS, products that are intended to help organizations and their customers build better relationships. With our origins in customer service, we have evolved our offerings over time to a family of products that work together to help organizations understand their customers, improve communications, and engage where and when it's needed most. Our product family is built upon a modern architecture that enables us and our customers to rapidly innovate, adapt our technology in novel ways, and easily integrate with other products and applications.

References to Zendesk, the "Company," "our," or "we" in these notes refer to Zendesk, Inc. and its subsidiaries on a consolidated basis.

Basis of Presentation

These unaudited condensed consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles, or GAAP, and applicable rules and regulations of the Securities and Exchange Commission, or SEC, regarding interim financial reporting. Certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Therefore, these condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes included in our Annual Report on Form 10-K, as amended by Form 10-K/A, for the year ended December 31, 2017, filed with the SEC on November 5, 2018. There have been no changes to our significant accounting policies described in the Annual Report on Form 10-K that have had a material impact on our condensed consolidated financial statements and related notes, except as described below.

Effective January 1, 2018, we adopted the requirements of Accounting Standards Update, or ASU, 2014-09, "Revenue from Contracts with Customers" regarding Accounting Standards Codification, or ASC, Topic 606 and ASU 2016-18, "Statement of Cash Flows - Restricted Cash," as discussed below. All amounts and disclosures set forth in this Form 10-Q have been updated to comply with the new standards, as indicated by "as adjusted."

The unaudited consolidated balance sheet as of December 31, 2017 included herein was derived from the audited financial statements as of that date, giving effect to the adoption of ASC 606, as discussed below. The unaudited condensed consolidated financial statements reflect all normal recurring adjustments necessary to present fairly our financial position, results of operations, comprehensive loss, and cash flows for the interim periods, but are not necessarily indicative of the results of operations to be anticipated for the full year ending December 31, 2018.

Use of Estimates

The preparation of our consolidated financial statements in conformity with GAAP requires management to make certain estimates, judgments, and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenue and expenses during the reported periods.

Significant items subject to such estimates and assumptions include the fair value of share-based awards, acquired intangible assets, and goodwill as well as unrecognized tax benefits, the useful lives of acquired intangible assets and property and equipment, the capitalization and estimated useful life of capitalized costs to obtain customer contracts and capitalized internal-use software, variable consideration related to revenue recognition, and financial forecasts used in currency hedging.

These estimates are based on information available as of the date of the financial statements; therefore, actual results could differ from those estimates.

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Concentrations of Risk

As of September 30, 2018, no customers represented 10% or greater of our total accounts receivable balance. There were no customers that individually exceeded 10% of our revenue during the three and nine months ended September 30, 2018 or 2017.

Recently Issued Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board, or FASB, issued ASU 2016-02, regarding ASC Topic 842 “Leases,” including subsequent amendments. This new guidance requires lessees to recognize most leases on their balance sheets as right-of-use assets with corresponding lease liabilities and eliminates certain real estate-specific provisions. The new guidance is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period. Early adoption is permitted. We have completed our process to identify our population of lease arrangements and we are nearing the completion of applying the new guidance to each arrangement. We are also in the process of determining the incremental borrowing rate for each arrangement. We plan to adopt utilizing the modified retrospective method of transition. While the adoption remains in progress, we expect that adoption will result in the recognition of right-of-use assets and lease liabilities that were not previously recognized, which will increase total assets and liabilities on our consolidated balance sheet.

In August 2017, the FASB issued ASU 2017-12, regarding ASC Topic 815 “Derivatives and Hedging.” This amendment simplifies various aspects of hedge accounting, including the measurement and presentation of hedge ineffectiveness and certain documentation and assessment requirements. The amendment also makes more hedging strategies eligible for hedge accounting. The guidance is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period. Early adoption is permitted. We are currently evaluating the effect of this standard on our consolidated financial statements.

In February 2018, the FASB issued ASU 2018-02, “Income Statement - Reporting Comprehensive Income,” which provides for the reclassification of the effect of remeasuring deferred tax balances related to items within accumulated other comprehensive income to retained earnings resulting from the Tax Cuts and Jobs Act, or Tax Act. The guidance is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period. Early adoption is permitted. We do not expect the adoption of this standard to have a material effect on our consolidated financial statements.

In June 2018, the FASB issued ASU 2018-07, regarding ASC Topic 718 “Compensation - Stock Compensation,” which largely aligns the accounting for share-based compensation for non-employees with employees. The guidance is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period. Early adoption is permitted. We do not expect the adoption of this standard to have a material effect on our consolidated financial statements.

In June 2018, the FASB issued ASU 2018-08, regarding ASC Topic 958 “Not-for-Profit Entities,” which clarified the guidance on how entities determine whether to account for a transfer of assets as an exchange transaction or a contribution. The guidance is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period. Early adoption is permitted. We do not expect the adoption of this standard to have a material effect on our consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, regarding ASC Topic 820 “Fair Value Measurement,” which modifies the disclosure requirements for fair value measurements for certain types of investments. The guidance is effective for annual reporting periods beginning after December 15, 2019, including interim periods within that reporting period. Early adoption is permitted. We do not expect the adoption of this standard to have a material effect on our consolidated financial statements.

In August 2018, the FASB issued ASU 2018-15, regarding ASC Topic 350-40 “Intangibles - Internal-Use Software,” which aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service

contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The guidance is effective for annual reporting periods beginning after December 15, 2019, including interim periods within that reporting period. Early adoption is permitted. We are currently evaluating the effect of this standard on our consolidated financial statements.

Recently Adopted Accounting Pronouncements

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In May 2014, the FASB issued new revenue guidance under ASU 2014-09 that provides principles for recognizing revenue when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for the promised goods or services provided to customers. ASC 606 and ASC 340-40 also require the deferral of incremental costs of obtaining contracts with customers and subsequent amortization of those costs over the period of anticipated benefit. Collectively, we refer to this guidance as “ASC 606.” We adopted ASC 606 on January 1, 2018, utilizing the full retrospective method of transition. The adoption resulted in changes to our accounting policies for revenue recognition and incremental costs to acquire contracts, as described below. We applied ASC 606 using the following practical expedients:

- consideration allocated to the remaining performance obligations and an explanation of when we expect to recognize that amount as revenue is not disclosed for comparative periods prior to the adoption date;
- completed contracts that included variable consideration utilize the final transaction price rather than an estimation of variable consideration for comparative periods prior to the adoption date; and
- costs of obtaining contracts with customers are expensed when the amortization period would have been one year or less.

The effect of adopting ASC 606 on our 2017 and 2016 revenues was not material. The primary effect relates to the deferral of sales commissions and other incremental costs to acquire contracts, which we historically expensed as incurred. The impact of adoption is summarized in the tables below. Under ASC 606, all incremental costs to acquire contracts are capitalized and amortized on a straight-line basis over the anticipated period of benefit, which we have determined to be three years.

In August 2016, the FASB issued ASU 2016-15, regarding ASC Topic 230 “Statement of Cash Flows.” This update addresses eight specific cash flow issues with the objective of reducing diversity in practice. The new guidance is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. We adopted this standard in the first quarter of 2018. The adoption did not have an effect on our consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, “Statement of Cash Flows - Restricted Cash,” which requires entities to show the changes in the total of cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flows. We adopted this standard in the first quarter of 2018 on a retrospective basis, resulting in an immaterial change to our previously reported statement of cash flows for the nine months ended September 30, 2017, which is summarized in the table below.

In January 2017, the FASB issued ASU 2017-01, “Business Combinations - Clarifying the Definition of a Business,” which clarifies the definition of a business when evaluating whether transactions should be accounted for as acquisitions or disposals of assets or businesses. We adopted this standard in the first quarter of 2018. The adoption did not have an effect on our consolidated financial statements.

In March 2018, the FASB issued ASU 2018-05, which amends ASC Topic 740 “Income Taxes” to conform with SEC Staff Accounting Bulletin 118, issued in December 2017. The guidance was issued to address the application of GAAP in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the Tax Act. The standard is effective upon issuance. We are nearing completion of our analysis of our deferred tax assets and liabilities and our historical foreign earnings as well as potential correlative adjustments. We will finalize our assessment in the fourth quarter of 2018.

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We adjusted our condensed consolidated financial statements from amounts previously reported due to the adoption of ASC 606 and ASU 2016-18. Select unaudited condensed consolidated balance sheet line items, which reflect the adoption of ASC 606 are as follows (in thousands):

	December 31, 2017		
	As Previously Reported	Adjustments	As Adjusted
Assets			
Deferred costs	\$—	\$ 15,771	\$15,771
Deferred costs, noncurrent	—	15,395	15,395
Liabilities and stockholders' equity			
Deferred revenue	\$174,524	\$ (1,377)	\$173,147
Accumulated deficit	\$(430,586)	\$ 32,543	\$(398,043)

Select unaudited condensed consolidated statement of operations line items, which reflect the adoption of ASC 606 are as follows (in thousands, except per share data):

	Three Months Ended September 30, 2017		
	As Previously Reported	Adjustments	As Adjusted
Revenue	\$112,786	\$ (521)	\$112,265
Operating expenses:			
Sales and marketing	56,778	(2,395)	54,383
Operating loss	(28,441)	1,874	(26,567)
Net loss	\$(27,689)	\$ 1,874	\$(25,815)
Net loss per share, basic and diluted	\$(0.28)	\$ 0.02	\$(0.26)
	Nine Months Ended September 30, 2017		
	As Previously Reported	Adjustments	As Adjusted
Revenue	\$307,066	\$ 1,183	\$308,249
Operating expenses:			
Sales and marketing	156,707	(5,643)	151,064
Operating loss	(86,119)	6,826	(79,293)
Net loss	\$(83,988)	\$ 6,826	\$(77,163)
Net loss per share, basic and diluted	\$(0.85)	\$ 0.07	\$(0.78)

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Select unaudited condensed consolidated statement of cash flows line items, which reflect the adoption of ASC 606 and ASU 2016-18 are as follows (in thousands):

	Nine Months Ended September 30, 2017		
	As Previously Reported	Adjustments	As Adjusted
Cash flow from operating activities			
Net loss	\$(83,988)	\$ 6,826	\$(77,163)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Share-based compensation	62,805	(380)	62,425
Amortization of deferred costs	—	10,332	10,332
Changes in operating assets and liabilities:			
Prepaid expenses and other current assets	(5,109)	(7)	(5,116)
Deferred costs	—	(15,595)	(15,595)
Other assets and liabilities	(5,513)	190	(5,323)
Deferred revenue	31,357	(1,183)	30,174
Net cash provided by operating activities	24,739	183	24,922
Net increase in cash, cash equivalents and restricted cash	(1,074)	183	(891)
Cash, cash equivalents and restricted cash at beginning of period	93,677	1,385	95,062
Cash, cash equivalents and restricted cash at end of period	\$92,603	\$ 1,568	\$94,171

We have also updated our significant accounting policies in connection with the adoption of ASC 606:

Revenue Recognition

We generate substantially all of our revenue from subscription services, which are comprised of subscription fees from customer accounts on Zendesk Support and, to a lesser extent, Chat, Talk, Guide, Connect, and Base. In addition, we generate revenue by providing additional features to certain of our subscription plans for a fee that is incremental to the base subscription rate for such plans. Subscription service arrangements are generally non-cancelable and do not provide for refunds to customers in the event of cancellations or any other right of return. We record revenue net of sales or excise taxes.

We also derive revenue from implementation, Talk usage, and training services, for which we recognize revenue upon completion.

Revenues are recognized when control of these services is transferred to our customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those services.

We determine revenue recognition through the following steps:

- Identification of the contract, or contracts, with a customer
- Identification of the performance obligations in the contract
- Determination of the transaction price
- Allocation of the transaction price to the performance obligations in the contract
- Recognition of revenue when, or as, the performance obligations are satisfied

Subscription revenue is recognized on a ratable basis over the contractual subscription term of the arrangement beginning on the date that our service is made available to the customer. Payments received in advance of services being rendered are recorded as deferred revenue.

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In limited circumstances, certain customers have arrangements that provide for a maximum number of users over the subscription term, with usage measured monthly. Incremental fees are incurred when the maximum number of users is exceeded. In determining the transaction price for these arrangements, we evaluate the expected usage pattern to estimate any incremental fees that we are entitled to throughout the subscription term and recognize revenue ratably over the subscription term. In making these assessments, we constrain our estimates based on factors that could lead to a probable reversal of revenue.

Certain of our product offerings include service-level agreements warranting defined levels of uptime reliability and performance and permitting those customers to receive credits for future services in the event that we fail to meet those levels. To date, we have not accrued for any significant liabilities in our consolidated financial statements as a result of these service-level agreements.

Costs to Obtain Customer Contracts

Sales commissions and related expenses are considered incremental and recoverable costs of acquiring customer contracts. These costs are capitalized and amortized on a straight-line basis over the anticipated period of benefit, which we have estimated to be three years. We determined the period of benefit by taking into consideration the length of our customer contracts, our technology lifecycle, and other factors. Amortization expense is recorded in sales and marketing expense within our consolidated statement of operations.

Deferred Revenue

We invoice customers for subscriptions to our products in monthly, quarterly, or annual installments. Deferred revenue consists primarily of customer billings made in advance of performance obligations being satisfied and revenue being recognized, and includes an immaterial amount of billings for subscriptions with customer cancellation rights. The term between invoicing and when payment is due is not significant and we do not provide financing arrangements to customers. Deferred revenue associated with performance obligations that are anticipated to be satisfied, and thus revenue recognized, during the succeeding 12-month period is recorded as current deferred revenue and the remaining portion is recorded as noncurrent deferred revenue. Deferred revenue associated with implementation, Talk usage, and training services was immaterial as of December 31, 2017 and September 30, 2018. We invoice customers based on billing schedules established in our contracts. Accounts receivable are recorded when the right to consideration becomes unconditional.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are recorded at the invoiced amount, net of allowance for doubtful accounts. The allowance is based upon historical loss patterns, the age of each past due invoice, and an evaluation of the potential risk of loss associated with delinquent accounts. Accounts receivable deemed uncollectable are charged against the allowance for doubtful accounts when identified. The balance of accounts receivable also includes contract assets, which are recorded when revenue is recognized in advance of invoicing.

Note 2. Business Combinations

FutureSimple Inc.

On September 10, 2018, we completed the acquisition of FutureSimple Inc., or FutureSimple, the developer of Base, a sales force automation software product. We acquired FutureSimple for purchase consideration of \$81.0 million in cash. We incurred transaction costs of \$1.6 million in connection with the acquisition, which were included within general and administrative expenses.

The fair value of assets acquired and liabilities assumed was based on a preliminary valuation, and our estimates and assumptions are subject to change within the measurement period. The primary areas that remain preliminary relate to the fair values of certain assets and liabilities acquired and residual goodwill. The total purchase consideration was allocated to the assets acquired and liabilities assumed as set forth below (in thousands). The excess of the purchase price over the net assets acquired was recorded as goodwill. Goodwill generated from the acquisition is primarily attributable to assembled workforce and expected growth from the expansion of the scope of and market opportunity for our products. Goodwill is not deductible for income tax purposes. Goodwill will not be amortized but instead will be tested for impairment at least annually and more frequently if certain indicators of impairment are present.

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Net tangible liabilities acquired	\$(3,371)
Identifiable intangible assets:	
Developed technology	19,000
Customer relationships	10,800
Backlog	1,500
Goodwill	53,094
Total purchase consideration	\$81,023

The developed technology, customer relationships, and backlog intangible assets were assigned useful lives of 6.5, 5.0, and 2.0 years, respectively.

In connection with the acquisition, we granted cash and share-based retention awards to certain employees of FutureSimple. The cash awards vest over a required service period and the share-based awards vest upon fulfillment of certain service and performance conditions. Each retention award will be recorded as expense based on the fulfillment of such service and performance conditions, as applicable, and is not included in the total purchase consideration.

From the date of the acquisition, the results of operations of FutureSimple have been included in and are immaterial to our consolidated financial statements. Pro forma revenue and results of operations have not been presented because the historical results of FutureSimple are not material to our consolidated financial statements in any period presented.

Outbound Solutions, Inc.

On April 27, 2017, we completed the acquisition of Outbound Solutions, Inc., or Outbound, a provider of software that enables companies to deliver intelligent, behavior-based messages across multiple channels. We acquired Outbound for purchase consideration of \$16.6 million in cash.

The total purchase consideration was allocated to the assets acquired and liabilities assumed as set forth below (in thousands). The excess of the purchase price over the net assets acquired was recorded as goodwill. Goodwill generated from the acquisition is primarily attributable to expected growth from the expansion of the scope of and market opportunity for our products. Goodwill is not deductible for income tax purposes. Goodwill will not be amortized but instead will be tested for impairment at least annually and more frequently if certain indicators of impairment are present.

Net tangible assets acquired	\$96
Net deferred tax liability recognized	(492)
Identifiable intangible assets:	
Developed technology	3,200
Customer relationships	410
Goodwill	13,350
Total purchase consideration	\$16,564

The developed technology and customer relationships intangible assets were assigned useful lives of 6.5 and 3.5 years, respectively.

From the date of the acquisition, the results of operations of Outbound have been included in and are immaterial to our consolidated financial statements. Pro forma revenue and results of operations have not been presented because the historical results of Outbound are not material to our consolidated financial statements in any period presented.

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Note 3. Financial Instruments

Investments

The following tables present information about our financial assets measured at fair value on a recurring basis based on the three-tier fair value hierarchy (in thousands):

Description	Fair Value Measurement at September 30, 2018		
	Level 1	Level 2	Total
Corporate bonds	\$—	\$443,934	\$443,934
Asset-backed securities	—	110,786	110,786
Money market funds	56,031	—	56,031
Commercial paper	—	51,730	51,730
U.S. treasury securities	—	50,690	50,690
Agency securities	—	15,489	15,489
Certificates of deposit	—	2,250	2,250
Total	\$56,031	\$674,879	\$730,910
Included in cash and cash equivalents			\$76,962
Included in marketable securities			\$653,948

Description	Fair Value Measurement at December 31, 2017		
	Level 1	Level 2	Total
Corporate bonds	\$—	\$149,069	\$149,069
Money market funds	32,832	—	32,832
U.S. treasury securities	—	28,382	28,382
Asset-backed securities	—	27,738	27,738
Commercial paper	—	19,622	19,622
Agency securities	—	14,911	14,911
Total	\$32,832	\$239,722	\$272,554
Included in cash and cash equivalents			\$37,531
Included in marketable securities			\$235,023

As of September 30, 2018 and December 31, 2017, there were no securities within Level 3 of the fair value hierarchy. There were no transfers between fair value measurement levels during the three and nine months ended September 30, 2018. Gross unrealized gains and losses for cash equivalents and marketable securities as of September 30, 2018 and December 31, 2017 were not material. Unrealized losses for securities that have been in an unrealized loss position for more than 12 months as of September 30, 2018 and December 31, 2017 were not material. The following table classifies our marketable securities by contractual maturity (in thousands):

	September 30, 2018	December 31, 2017
Due in one year or less	\$293,598	\$137,576
Due after one year	360,350	97,447
Total	\$653,948	\$235,023

For our other financial instruments, including accounts receivable, accounts payable, and other current liabilities, the carrying amounts approximate their fair values due to the relatively short maturity of these balances.

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Derivative Instruments and Hedging

Our foreign currency exposures typically arise from expenditures associated with foreign operations and sales in foreign currencies of our products. To mitigate the effect of foreign currency fluctuations on our future cash flows and earnings, we enter into foreign currency forward contracts with certain financial institutions and designate those contracts as cash flow hedges. Our foreign currency forward contracts generally have maturities of 15 months or less. As of September 30, 2018, the balance of accumulated other comprehensive loss included an unrecognized net loss of \$2.5 million related to the effective portion of changes in the fair value of foreign currency forward contracts designated as cash flow hedges. We expect to reclassify a net loss of \$2.7 million into earnings over the next 12 months associated with our cash flow hedges.

The following tables present information about our derivative instruments on our consolidated balance sheets (in thousands):

Derivative Instrument	September 30, 2018		September 30, 2018	
	Asset Derivatives		Liability Derivatives	
	Balance Sheet Location	Fair Value (Level 2)	Balance Sheet Location	Fair Value (Level 2)
Foreign currency forward contracts	Other current assets	\$1,731	Accrued liabilities	\$4,593
Total		\$1,731		\$4,593

Derivative Instrument	December 31, 2017		December 31, 2017	
	Asset Derivatives		Liability Derivatives	
	Balance Sheet Location	Fair Value (Level 2)	Balance Sheet Location	Fair Value (Level 2)
Foreign currency forward contracts	Other current assets	\$2,359	Accrued liabilities	\$1,220
Total		\$2,359		\$1,220

Our foreign currency forward contracts had a total notional value of \$179.9 million and \$139.7 million as of September 30, 2018 and December 31, 2017, respectively. We have master netting arrangements with each of our counterparties, which permit net settlement of multiple, separate derivative contracts with a single payment. We may also be required to exchange cash collateral with certain of our counterparties on a regular basis. ASC 815 permits companies to present the fair value of derivative instruments on a net basis according to master netting arrangements. We have elected to present our derivative instruments on a gross basis in our consolidated financial statements. As of September 30, 2018 and December 31, 2017, there was no cash collateral posted with counterparties.

The following table presents information about our derivative instruments on our condensed consolidated statements of operations (in thousands):

Hedging Instrument Location of Loss Reclassified into Earnings	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2018	
	Loss Recognized in AOCI	Loss Reclassified from AOCI into Earnings	Loss Recognized in AOCI	Loss Reclassified from AOCI into Earnings