SPLUNK INC
Form 10-Q
December 09, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(MARK ONE)

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

FOR THE QUARTERLY PERIOD ENDED OCTOBER 31, 2016

OR

o 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 001-35498

SPLUNK INC.
(Exact name of registrant as specified in its charter)

Delaware	86-1106510
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

250 Brannan Street
San Francisco, California 94107
(Address of principal executive offices)
(Zip Code)

(415) 848-8400
(Registrant’s telephone number, including area code)

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

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 ý NO o

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. (Check one):

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

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

There were 135,660,772 shares of the registrant’s Common Stock issued and outstanding as of December 1, 2016.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements (Unaudited)

Splunk Inc.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share amounts)
(Unaudited)

	October 31, 2016	January 31, 2016
Assets		
Current assets		
Cash and cash equivalents	$365,593	$424,541
Investments, current portion	661,406	584,498
Accounts receivable, net	172,489	181,665
Prepaid expenses and other current assets	29,743	26,565
Total current assets	1,229,231	1,217,269
Investments, non-current	5,000	1,500
Property and equipment, net	159,823	134,995
Intangible assets, net	40,423	49,482
Goodwill	124,642	123,318
Other assets	15,845	10,275
Total assets	$1,574,964	$1,536,839
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	$6,395	$4,868
Accrued payroll and compensation	83,360	95,898
Accrued expenses and other liabilities	78,873	49,879
Deferred revenue, current portion	385,519	347,121
Total current liabilities	554,147	497,766
Deferred revenue, non-current	113,636	102,382
Other liabilities, non-current	93,010	77,277
Total non-current liabilities	206,646	179,659
Total liabilities	760,793	677,425
Commitments and contingencies (Note 3)		
Stockholders’ equity		
Common stock: $0.001 par value; 1,000,000,000 shares authorized; 135,582,772 shares issued and outstanding at October 31, 2016, and 131,543,467 shares issued and outstanding at January 31, 2016	136	132
Accumulated other comprehensive loss	(3,010)	(3,770)
Additional paid-in capital	1,763,624	1,528,647
Accumulated deficit	(946,579)	(665,595)
Total stockholders’ equity	814,171	859,414
Total liabilities and stockholders’ equity	$1,574,964	$1,536,839

The accompanying notes are an integral part of these condensed consolidated financial statements.

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Splunk Inc.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2016	2015	2016	2015
Revenues				
License	$139,725	$104,164	$356,412	$263,996
Maintenance and services	105,064	70,256	287,082	184,415
Total revenues	244,789	174,420	643,494	448,411
Cost of revenues [(1)]				
License	2,883	3,136	8,713	6,110
Maintenance and services	45,791	27,455	124,077	72,606
Total cost of revenues	48,674	30,591	132,790	78,716
Gross profit	196,115	143,829	510,704	369,695
Operating expenses [(1)]				
Research and development	85,659	56,186	220,254	149,192
Sales and marketing	167,330	130,131	462,709	343,906
General and administrative	34,079	29,857	100,464	85,489
Total operating expenses	287,068	216,174	783,427	578,587
Operating loss	(90,953)	(72,345)	(272,723)	(208,892)
Interest and other income (expense), net				
Interest income (expense), net	(823)	377	(2,023)	1,162
Other income (expense), net	(348)	(271)	(2,536)	(477)
Total interest and other income (expense), net	(1,171)	106	(4,559)	685
Loss before income taxes	(92,124)	(72,239)	(277,282)	(208,207)
Income tax provision (benefit)	1,367	735	3,702	(8,758)
Net loss	$(93,491)	$(72,974)	$(280,984)	$(199,449)
Basic and diluted net loss per share	$(0.69)	$(0.57)	$(2.11)	$(1.58)
Weighted-average shares used in computing basic and diluted net loss per share	134,677	128,368	133,273	126,534

[(1)] Amounts include stock-based compensation expense, as follows:

Cost of revenues	$7,610	$6,384	$22,475	$18,578
Research and development	45,355	22,534	102,303	61,910
Sales and marketing	38,750	33,247	118,354	91,067
General and administrative	13,299	11,999	42,115	32,327

The accompanying notes are an integral part of these condensed consolidated financial statements.

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Splunk Inc.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(In thousands)
(Unaudited)

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2016	2015	2016	2015
Net loss	$(93,491)	$(72,974)	$(280,984)	$(199,449)
Other comprehensive loss				
Net unrealized gain (loss) on investments	(336)	(47)	20	(92)
Foreign currency translation adjustments	(900)	(87)	740	(1,369)
Total other comprehensive gain (loss)	(1,236)	(134)	760	(1,461)
Comprehensive loss	$(94,727)	$(73,108)	$(280,224)	$(200,910)

The accompanying notes are an integral part of these condensed consolidated financial statements.

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Splunk Inc.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended October 31,	
	2016	2015
Cash flows from operating activities		
Net loss	$(280,984)	$(199,449)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	22,914	13,467
Amortization of investment premiums	620	1,049
Stock-based compensation	285,247	203,882
Deferred income taxes	(620)	(11,416)
Excess tax benefits from employee stock plans	(551)	(995)
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable, net	9,176	2,756
Prepaid expenses, other current and non-current assets	(8,128)	15,630
Accounts payable	1,530	384
Accrued payroll and compensation	(12,538)	12,341
Accrued expenses and other liabilities	32,992	(3,839)
Deferred revenue	49,652	44,803
Net cash provided by operating activities	99,310	78,613
Cash flows from investing activities		
Purchases of investments	(523,783)	(219,195)
Maturities of investments	446,275	399,145
Acquisitions, net of cash acquired	—	(142,693)
Purchases of property and equipment	(27,219)	(24,496)
Other investment activities	(3,500)	(1,500)
Net cash provided by (used in) investing activities	(108,227)	11,261
Cash flows from financing activities		
Proceeds from the exercise of stock options	7,355	12,696
Excess tax benefits from employee stock plans	551	995
Proceeds from employee stock purchase plan	15,183	10,906
Taxes paid related to net share settlement of equity awards	(73,355)	—
Net cash provided by (used in) financing activities	(50,266)	24,597
Effect of exchange rate changes on cash and cash equivalents	235	(95)
Net increase (decrease) in cash and cash equivalents	(58,948)	114,376
Beginning of period	424,541	387,315
End of period	$365,593	$501,691
Supplemental disclosures		
Cash paid for income taxes	$2,421	$935
Cash paid for interest expense related to build-to-suit lease	3,026	—
Non-cash investing and financing activities		
Accrued purchases of property and equipment	(1,209)	343
Vesting of early exercised options	—	56
Capitalized construction costs related to build-to-suit lease	10,065	33,119

The accompanying notes are an integral part of these condensed consolidated financial statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(1) Description of the Business and Significant Accounting Policies

Business

Splunk Inc. ("we," "us," "our") provides innovative software solutions that enable organizations to gain real-time operational intelligence by harnessing the value of their data. Our offerings enable users to collect, index, search, explore, monitor and analyze data regardless of format or source. Our offerings address large and diverse data sets, commonly referred to as big data, and are specifically tailored for machine data. Machine data is produced by nearly every software application and electronic device and contains a definitive, time-stamped record of various activities, such as transactions, customer and user activities and security threats. Our offerings help users derive new insights from machine data that can be used to, among other things, improve service levels, reduce operational costs, mitigate security risks, demonstrate and maintain compliance, and drive better business decisions. We were incorporated in California in October 2003 and reincorporated in Delaware in May 2006.

Fiscal Year

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

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States ("GAAP") and applicable rules and regulations of the Securities and Exchange Commission ("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. The condensed consolidated balance sheet data as of January 31, 2016 was derived from audited financial statements, but does not include all disclosures required by GAAP. Therefore, these condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Annual Report on Form 10-K for the fiscal year ended January 31, 2016, filed with the SEC on March 30, 2016. There have been no changes in the significant accounting policies from those that were disclosed in the audited consolidated financial statements for the fiscal year ended January 31, 2016 included in the Annual Report on Form 10-K.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all normal recurring adjustments necessary to state fairly the 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 fiscal year 2017.

Recently Issued Accounting Pronouncements

In October 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-16 (Topic 740), Intra-Entity Transfers of Assets Other Than Inventory. The new standard will require companies to recognize, as opposed to defer, the tax effects from intercompany transfers of certain assets when the transfer occurs. The standard is effective for our first quarter of fiscal 2019, although early adoption is permitted. We are currently evaluating adoption methods and whether this standard will have a material impact on our condensed consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13 (Topic 326), Financial Instruments - Credit Losses. The amendments in this update require a financial asset (or a group of financial assets) measured at an amortized cost basis to be presented at the net amount expected to be collected. The new approach to estimating credit losses (referred to as the current expected credit losses model) applies to most financial assets measured at amortized cost and certain other instruments, including trade and other receivables, loans and held-to-maturity debt securities. The standard is effective for our first quarter of fiscal 2021, although early adoption is permitted. We are currently evaluating adoption methods and whether this standard will have a material impact on our condensed consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09 (Topic 718), Compensation - Stock Compensation, which has been issued as part of its Simplification Initiative. The areas for simplification in this update involve several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either

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equity or liabilities and classification on the statement of cash flows. The standard is effective for our first quarter of fiscal 2018, although early adoption is permitted. We are currently evaluating adoption methods and whether this standard will have a material impact on our condensed consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02 (Topic 842), Leases, which supersedes the lease recognition requirements in ASC Topic 840, Leases. The standard requires an entity to recognize right-of-use assets and lease liabilities arising from a lease for operating leases, initially measured at the present value of the lease payments on the condensed consolidated balance sheets. The impact of such leases on the condensed consolidated statement of operations and cash flows will continue to be treated in a similar manner under current GAAP. The standard also requires additional qualitative and quantitative disclosures. The standard is effective for our first quarter of fiscal 2020, although early adoption is permitted. We are currently evaluating adoption methods and whether this standard will have a material impact on our condensed consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09 (Topic 606), Revenue from Contracts with Customers, which supersedes the revenue recognition requirements in Accounting Standards Codification 605, Revenue Recognition and establishes a new revenue standard. This ASU is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU also requires additional disclosure about the nature, amount, timing and uncertainty of revenues and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. In March 2016, the FASB issued ASU No. 2016-08, Revenue from Contracts with Customers: Principal versus Agent Considerations, which clarifies the guidance in the new revenue standard on assessing whether an entity is a principal or an agent in a revenue transaction. This conclusion impacts whether an entity reports revenue on a gross or net basis. In April 2016, the FASB issued ASU No. 2016-10, Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing, which clarifies the guidance in the new revenue standard regarding an entity's identification of its performance obligations in a contract. In May 2016, the FASB issued ASU No. 2016-12, Narrow-Scope Improvements and Practical Expedients, which amends the guidance in the new revenue standard on collectibility, non-cash consideration, presentation of sales tax, and transition. The new revenue standard, as amended by ASU No. 2015-14, is effective in the first quarter of fiscal 2019 and may be applied retrospectively to each prior period presented or with the cumulative effect recognized as of the date of initial application. We currently anticipate adopting the standard using the cumulative effect transition method. Early adoption is permitted, but not earlier than the original effective date for annual and interim periods. While we are still evaluating the total impact of the new revenue standard, we believe the adoption of this new standard will have a material impact on our condensed consolidated financial statements, including the way we account for arrangements involving a term license. Under the new revenue standard, we would be required to recognize term license revenues upfront and the associated maintenance revenues over the contract period. Under the current revenue standard, we recognize both the term license and maintenance revenues ratably over the contract period.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting periods covered by the financial statements and accompanying notes. In particular, we make estimates with respect to the fair value of multiple elements in revenue recognition, uncollectible accounts receivable, the assessment of the useful life and recoverability of long-lived assets (property and equipment, goodwill and identified intangibles), stock-based compensation expense, the fair value of assets acquired and liabilities assumed for business combinations, income taxes and contingencies. Actual results could differ from those estimates.

Segments

We operate our business as one operating segment: the development and marketing of software solutions that enable our customers to gain real-time operational intelligence by harnessing the value of their data. Our chief operating decision maker is our Chief Executive Officer, who reviews financial information presented on a consolidated basis for purposes of making operating decisions, assessing financial performance and allocating resources.

Principles of Consolidation

The accompanying unaudited condensed consolidated financial statements include the accounts of Splunk Inc. and its direct and indirect wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated upon consolidation.

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Foreign Currency

The functional currencies of our foreign subsidiaries are their respective local currencies. Translation adjustments arising from the use of differing exchange rates from period to period are included in Accumulated other comprehensive loss within the condensed consolidated statement of stockholders' equity. Foreign currency transaction gains and losses are included in Other income (expense), net and were not material for the three and nine months ended October 31, 2016 and 2015. All assets and liabilities denominated in a foreign currency are translated into U.S. dollars at the exchange rate on the balance sheet date. Expenses are translated at the average exchange rate during the period. Equity transactions are translated using historical exchange rates.

Foreign Currency Contracts

We use foreign currency forward contracts as a part of our strategy to manage exposure related to foreign currency denominated monetary assets and liabilities. These contracts typically have maturities of one month. They are not designated as cash flow or fair value hedges under ASC Topic 815, Derivatives and Hedging. These contracts hedge assets and liabilities that are denominated in foreign currencies and are carried at fair value as either assets or liabilities on the condensed consolidated balance sheets with changes in the fair value recorded to Other income (expense), net in the condensed consolidated statements of operations.

Investments

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

Business Combinations

We use our best estimates and assumptions to allocate the fair value of purchase consideration to the tangible and intangible assets acquired and liabilities assumed based on their estimated fair values. The excess of the fair value of purchase consideration over the fair values of these identifiable assets and liabilities is recorded as goodwill. Our estimates are inherently uncertain and subject to refinement. During the measurement period, which may be up to one year from the acquisition date, we may record adjustments to the fair value of these tangible and intangible assets acquired and liabilities assumed, with the corresponding offset to goodwill. In addition, uncertain tax positions and tax-related valuation allowances are initially established in connection with a business combination as of the acquisition date. We continue to collect information and reevaluate these estimates and assumptions quarterly and record any adjustments to our preliminary estimates to goodwill provided that we are within the measurement period. Upon the conclusion of the final determination of the fair value of assets acquired or liabilities assumed during the measurement period, any subsequent adjustments are recorded to our condensed consolidated statements of operations.

(2) Investments and Fair Value Measurements

The carrying amounts of certain of our financial instruments including cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate fair value due to their short-term maturities.

Assets and liabilities recorded at fair value in the financial statements are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Hierarchical levels that are directly related to the amount of subjectivity associated with the inputs to the valuation of these assets or liabilities are as follows:

Level 1—Observable inputs, such as quoted prices in active markets for identical assets or liabilities.

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Level 2—Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Assets and liabilities measured at fair value are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires management to make judgments and consider factors specific to the asset or liability.

The following table sets forth the fair value of our financial assets and liabilities that were measured on a recurring basis as of October 31, 2016 and January 31, 2016 (in thousands):

	October 31, 2016				January 31, 2016			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets:								
Money market funds	$344,892	$ —	$ —	$344,892	$374,571	$ —	$ —	$374,571
U.S. treasury securities	—	661,406	—	661,406	—	607,892	—	607,892
Other	—	—	3,000	3,000	—	—	1,500	1,500
Reported as:								
Assets:								
Cash and cash equivalents				$344,892				$397,965
Investments, current portion				661,406				584,498
Investments, non-current				3,000				1,500
Total				$1,009,298				$983,963

Our investments in money market funds are measured at fair value on a recurring basis. These money market funds are actively traded and reported daily through a variety of sources. The fair value of the money market fund investments is classified as Level 1.

The following table represents our investments in U.S. treasury securities, which we have classified as available-for-sale investments as of October 31, 2016 (in thousands):

	October 31, 2016			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Investments, current portion:				
U.S. treasury securities	$661,442	$ 185	$ (221)	$661,406
Total available-for-sale investments in U.S. treasury securities	$661,442	$ 185	$ (221)	$661,406

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

	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. treasury securities	$361,669	$ (221)	$ —	$ —	$361,669	$ (221)

As of October 31, 2016, we did not consider any of our investments to be other-than-temporarily impaired.

The contractual maturities of our investments in U.S. treasury securities are as follows (in thousands):

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	October 31, 2016
Due within one year	$661,406
Total	$661,406

Investments with maturities of less than 12 months from the balance sheet date are classified as current assets, which are available for use to fund current operations. Investments with maturities greater than 12 months from the balance sheet date are classified as long-term assets.

Assets Measured at Fair Value on a Recurring Basis Using Significant Unobservable Inputs

During fiscal 2016, we made an investment in the form of a convertible promissory note in a privately-held company that we have classified as an available-for-sale investment, which is included in investments, non-current, on our condensed consolidated balance sheets. During fiscal 2017, we made an additional $1.5 million convertible promissory note investment in this privately-held company. These investments are recorded at fair value using significant unobservable inputs or data in an inactive market and the valuation requires our judgment due to the absence of quoted prices in active markets and inherent lack of liquidity. Unrealized gains and losses on our available-for-sale investments are excluded from earnings and reported, net of tax, as a separate component on the condensed consolidated statements of comprehensive income (loss). During the nine months ended October 31, 2016, we have not recognized any unrealized gains or losses or an other-than-temporary impairment charge on these investments. The carrying value of these investments were $3.0 million and $1.5 million as of October 31, 2016 and January 31, 2016, respectively.

(3) Commitments and Contingencies

Operating Lease Commitments

We lease our office spaces under non-cancelable leases and rent expense associated with our operating leases is recognized on a straight-line basis over the lease term. Rent expense for our operating leases was $6.0 million and $3.1 million for the three months ended October 31, 2016 and 2015, respectively, and $12.7 million and $8.9 million for the nine months ended October 31, 2016 and 2015, respectively.

On August 24, 2015, we entered into an office lease for approximately 235,000 square feet located at 3098 Olsen Drive, San Jose, California. Rent expense for this lease commenced in the third quarter of fiscal 2017. Our total obligation for the base rent is approximately $120.5 million.

The following summarizes our operating lease commitments as of October 31, 2016 (in thousands):

	Payments Due by Period				
	Total	Less Than 1 year	1-3 years	3-5 years	More Than 5 years
Operating lease commitments [1]	$180,672	$ 17,572	$46,349	$36,811	$ 79,940

[1] We entered into sublease agreements for portions of our office space and the future rental income of $1.2 million from these agreements has been included as an offset to our future minimum rental payments.

Financing Lease Obligation

On April 29, 2014, we entered into an office lease (the “Lease”) for approximately 182,000 square feet located at 270 Brannan Street, San Francisco, California (the “Premises”) for a term of 84 months. Our total obligation for the base rent

is approximately $92.0 million. On May 13, 2014, we entered into an irrevocable, standby letter of credit with Silicon Valley Bank for $6.0 million to serve as a security deposit for the Lease.

As a result of our involvement during the construction period, whereby we had certain indemnification obligations related to the construction, we were considered for accounting purposes only, the owner of the construction project under build-to-suit lease accounting. We have recorded estimated project construction costs incurred by the landlord as an asset and a corresponding long term liability in “Property and equipment, net” and “Other liabilities, non-current,” respectively, on our condensed consolidated balance sheets. During the construction period, we increased the asset and corresponding long term liability as additional building costs were incurred by the landlord. The landlord completed the construction of the Premises in February 2016 and we have determined that the lease does not meet the criteria for “sale-leaseback” treatment, due to our

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continuing involvement in the project resulting from our standby letter of credit. Accordingly, the Lease will continue to be accounted for as a financing obligation.

As of October 31, 2016, future payments on the financing lease obligation are as follows (in thousands):

Fiscal Period:	
Remaining three months of fiscal 2017	$1,568
Fiscal 2018	11,683
Fiscal 2019	12,510
Fiscal 2020	12,886
Fiscal 2021	13,272
Fiscal 2022	13,670
Thereafter	21,977
Total future minimum lease payments	$87,566

Legal Proceedings

We are subject to certain routine legal and regulatory proceedings, as well as demands and claims that arise in the normal course of our business. We make a provision for a liability relating to legal matters when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impact of negotiations, estimated settlements, legal rulings, advice of legal counsel and other information and events pertaining to a particular matter. In our opinion, resolution of any pending claims (either individually or in the aggregate) is not expected to have a material adverse impact on our condensed consolidated results of operations, cash flows or financial position, nor is it possible to provide an estimated amount of any such loss. However, depending on the nature and timing of any such dispute, an unfavorable resolution of a matter could materially affect our future results of operations or cash flows, or both, in a particular quarter.

Indemnification Arrangements

During the ordinary course of business, we may indemnify, hold harmless and agree to reimburse for losses suffered or incurred, our customers, vendors and their affiliates for certain intellectual property infringement and other claims by third parties with respect to our offerings, in connection with our commercial license arrangements or related to general business dealings with those parties.

As permitted under Delaware law, we have entered into indemnification agreements with our officers, directors and certain employees, indemnifying them for certain events or occurrences while they serve as our officers or directors or those of our direct and indirect subsidiaries.

To date, there have not been any costs incurred in connection with such indemnification obligations; therefore, there is no accrual of such amounts at October 31, 2016. We are unable to estimate the maximum potential impact of these indemnifications on our future results of operations.

(4) Property and Equipment

Property and equipment are stated at cost, net of accumulated depreciation and amortization. These assets are depreciated and amortized using the straight-line method over their estimated useful lives. Property and equipment consisted of the following (in thousands):

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	As of October 31, 2016	January 31, 2016
Computer equipment and software	$53,073	$43,883
Furniture and fixtures	16,751	13,398
Leasehold and building improvements [(1)]	56,904	41,028
Building [(2)]	82,250	72,186
	208,978	170,495
Less: accumulated depreciation and amortization	(49,155)	(35,500)
Property and equipment, net	$159,823	$134,995

[(1)] Includes costs related to assets not yet placed into service of $16.4 million and $28.9 million, as of October 31, 2016 and January 31, 2016, respectively.
[(2)] This relates to the capitalization of construction costs in connection with our build-to-suit lease obligation, where we are considered the owner of the asset, for accounting purposes only. There is a corresponding long-term liability for this asset on our condensed consolidated balance sheets under “Other liabilities, non-current.” Refer to Note 3 “Commitments and Contingencies” for details.

Depreciation and amortization expense on Property and Equipment, net was $5.3 million and $2.5 million for the three months ended October 31, 2016 and 2015, respectively, and $13.7 million and $7.4 million for the nine months ended October 31, 2016 and 2015, respectively.

(5) Acquisitions, Goodwill and Intangible Assets

Metafor Software

On June 23, 2015, we acquired 100% of the voting equity interest of Metafor Software Inc. (“Metafor Software”), a privately-held British Columbia corporation, which develops technology that provides anomaly detection and behavioral analytics for IT operations. This acquisition has been accounted for as a business combination. The purchase price of $16.4 million, paid in cash, was allocated as follows: $2.7 million to identifiable intangible assets, $0.5 million to net assets acquired and $0.1 million to net deferred tax assets, with the excess $13.1 million of the purchase price over the fair value of net tangible and intangible assets acquired recorded as goodwill, allocated to our one operating segment.

Caspida

On July 9, 2015, we acquired 100% of the voting equity interest of Caspida, Inc. (“Caspida”), a privately-held Delaware corporation, which develops technology that provides behavioral analytics to help detect, respond to and mitigate advanced security threats and insider security threats. This acquisition has been accounted for as a business combination. The purchase price of $128.4 million, paid in cash, was allocated as follows: $45.8 million to identifiable intangible assets, $11.4 million to net deferred tax liability and $1.2 million to net assets acquired, with the excess $92.8 million of the purchase price over the fair value of net tangible and intangible assets acquired recorded as goodwill, allocated to our one operating segment.

Per the terms of the merger agreement with Caspida, certain unvested shares of stock and unvested stock options held by Caspida employees were canceled and exchanged for unvested restricted stock units and replacement stock options to purchase shares of our common stock under our 2012 Equity Incentive Plan. Additionally, certain shares of stock held by key employees of Caspida were canceled and exchanged for unregistered restricted shares of our common stock subject to vesting. The fair value of $61.6 million of these issued awards, which are subject to the recipient's

continued service with us and thus excluded from the purchase price, is recognized ratably as stock-based compensation expense over the required service period.

Unaudited Pro Forma Financial Information

The following unaudited pro forma information presents the combined results of operations as if the acquisition of Caspida had been completed on February 1, 2014. The unaudited pro forma results include: (i) amortization associated with preliminary estimates for the acquired intangible assets; (ii) recognition of post-acquisition stock-based compensation; and (iii) the associated tax impact on these unaudited pro forma adjustments.

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The unaudited pro forma results do not reflect any cost saving synergies from operating efficiencies or the effect of the incremental costs incurred in integrating the two companies. Accordingly, these unaudited pro forma results are presented for informational purpose only and are not necessarily indicative of what the actual results of operations of the combined company would have been if the acquisition had occurred at the beginning of the period presented, nor are they indicative of future results of operations (in thousands, except per share amounts):

	Three Months Ended October 31, 2015	Nine Months Ended October 31, 2015
Revenues	$174,420	$448,411
Net loss	$(72,953)	$(222,515)
Basic and diluted net loss per share	$(0.57)	$(1.76)

Goodwill

Goodwill balances are presented below (in thousands):

	Carrying amount
Balance as of January 31, 2016	$123,318
Foreign currency translation adjustments	1,324
Balance as of October 31, 2016	$124,642

Intangible Assets

Intangible assets subject to amortization obtained from acquisitions as of October 31, 2016 are as follows (in thousands, except useful life):

	Gross Fair Value	Accumulated Amortization	Net Book Value	Weighted Average Remaining Useful Life (months)
Developed technology	$59,370	$ (20,572)	$38,798	52
Customer relationships	1,810	(1,700)	110	19
Other acquired intangible assets	1,180	(965)	215	19
Total intangible assets subject to amortization	$62,360	$ (23,237)	$39,123	

Additionally, we obtained $1.3 million of in-process research and development upon the acquisition of Caspida, which has an indefinite useful life. We will assess the carrying value and useful life of the asset once the associated research and development efforts are completed.

Amortization expense from acquired intangible assets was $3.0 million and $3.1 million for the three months ended October 31, 2016 and 2015, respectively, and $9.2 million and $6.1 million for the nine months ended October 31, 2016 and 2015, respectively.

The expected future amortization expense for acquired intangible assets as of October 31, 2016 is as follows (in thousands):

Fiscal Period:	
Remaining three months of fiscal 2017	$2,717
Fiscal 2018	10,293

Fiscal 2019	8,032
Fiscal 2020	7,622
Fiscal 2021	7,383
Thereafter	3,076
Total amortization expense	$39,123

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(6) Debt Financing Facilities

On May 9, 2013 we entered into a Loan Agreement with Silicon Valley Bank, which was most recently amended in May 2015. As amended, the agreement provides for a revolving line of credit facility, which expires May 9, 2017. Under the agreement, we are able to borrow up to $25 million. Interest on any drawdown under the revolving line of credit accrues either at the prime rate (3.50% in October 2016) or the LIBOR rate plus 2.75%. As of October 31, 2016, we had no balance outstanding under this agreement. The agreement contains customary financial covenants and other affirmative and negative covenants. We were in compliance with all covenants as of October 31, 2016.

(7) Stock Compensation Plans

The following table summarizes the stock option, restricted stock unit ("RSU") and performance unit ("PSU") award activity during the nine months ended October 31, 2016:

		Options Outstanding				RSUs and PSUs Outstanding
	Shares Available for Grant	Shares	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value [1] (in thousands)	Shares
Balances as of January 31, 2016	6,553,144	3,715,999	$ 4.72	4.24	$ 154,696	14,752,253
Additional shares authorized	6,577,173					
Options exercised		(1,358,297)	5.41			
Options forfeited and expired	13,364	(13,364)	2.76			
RSUs and PSUs granted	(2,945,024)					2,945,024
RSUs and PSUs vested						(3,704,488)
Shares withheld related to net share settlement of RSUs and PSUs	1,355,141					
RSUs and PSUs forfeited and canceled	1,082,635					(1,082,635)
Balances as of October 31, 2016	12,636,433	2,344,338	$ 4.33	3.44	$ 131,108	12,910,154
Vested and expected to vest		2,344,219	$ 4.33	3.44	$ 131,102	12,515,524
Exercisable as of October 31, 2016		2,297,648	$ 4.32	3.35	$ 128,471	

[1] The intrinsic value is calculated as the difference between the exercise price of the underlying stock option award and the closing market price of our common stock as of October 31, 2016.

Beginning in fiscal 2016, we granted PSUs to certain executives under our 2012 Equity Incentive Plan. The number of PSUs earned and eligible to vest will be determined after a one-year performance period, based on achievement of certain company financial performance measures and the recipient's continued service with us. The number of shares of our stock to be received at vesting can range from 0% to 200% of the target amount. Compensation expense for PSUs is measured using the fair value at the date of grant and recorded over the vesting period under the graded-vesting attribution method, and may be adjusted over the vesting period based on interim estimates of performance against the pre-set objectives.

During the nine months ended October 31, 2016, $0.6 million of tax benefits have been realized from exercised stock options. At October 31, 2016, total unrecognized compensation cost related to these stock options was $2.7 million,

adjusted for estimated forfeitures, which is expected to be recognized over a weighted-average period of 1.7 years. At October 31, 2016, total unrecognized compensation cost was $548.4 million related to RSUs, adjusted for estimated forfeitures, which is expected to be recognized over the next 2.5 years. At October 31, 2016, total unrecognized compensation cost was $19.2 million related to PSUs, adjusted for estimated forfeitures, which is expected to be recognized over the next 3.1 years. Additionally, during fiscal 2016, we issued 671,782 restricted shares of our common stock (“RSAs”) and at October 31, 2016, total unrecognized compensation cost was $15.4 million related to RSAs, adjusted for estimated forfeitures, which is expected to be recognized over the next 2.2 years. At October 31, 2016, 403,719 RSAs were vested and 268,063 RSAs were outstanding.

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The total intrinsic value of options exercised during the nine months ended October 31, 2016 was $67.8 million. The weighted-average grant date fair value of RSUs granted was $53.18 per share for the nine months ended October 31, 2016. The weighted-average grant date fair value of PSUs granted was 49.25 per share for the nine months ended October 31, 2016. The weighted-average grant date fair value of RSAs granted was $69.00 per share during fiscal 2016. No RSAs were granted during the nine months ended October 31, 2016.

(8) Geographic Information

Revenues

Revenues by geography are based on the shipping address of the customer. The following table presents our revenues by geographic region for the periods presented (in thousands):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2016	2015	2016	2015
United States	$190,123	$134,948	$493,001	$344,408
International	54,666	39,472	150,493	104,003
Total revenues	$244,789	$174,420	$643,494	$448,411

Other than the United States, no other individual country exceeded 10% of total revenues during any of the periods presented. One channel partner represented approximately 27% and 11% of total revenues during the three months ended October 31, 2016 and 2015, respectively, and approximately 25% of total revenues during the nine months ended October 31, 2016. A second channel partner represented approximately 21% of total revenues during the three months ended October 31, 2016 and 2015, and approximately 18% and 15% of total revenues during the nine months ended October 31, 2016 and 2015, respectively. The revenues from these channel partners are comprised of a number of customer transactions, none of which were individually greater than 10% of total revenues for the three months or nine months ended October 31, 2016 or 2015.

At October 31, 2016, one channel partner represented 29% and another channel partner represented 12% of total accounts receivable. At January 31, 2016, one channel partner represented 26% and one customer represented 16% of total accounts receivable.

Property and Equipment

The following table presents our property and equipment by geographic region for the periods presented (in thousands):

	As of October 31, 2016	January 31, 2016
United States	$153,274	$129,268
International	6,549	5,727
Total property and equipment, net	$159,823	$134,995

Other than the United States, no other country represented 10% or more of our total property and equipment as of October 31, 2016 or January 31, 2016.

(9) Income Taxes

For the three months ended October 31, 2016 and 2015, we recorded $1.4 million and $0.7 million in income tax expense, respectively. The increase in income tax expense was primarily due to an increase in taxable income in our international jurisdictions. For the nine months ended October 31, 2016 and 2015, we recorded $3.7 million in income tax expense and $8.8 million in income tax benefit, respectively. The increase in income tax expense was primarily attributable to the absence of the partial release of the valuation allowance as a result of a prior year acquisition and an increase in taxable income in our international jurisdictions. We recorded income taxes that were principally attributable to foreign and state taxes.

During the three months ended October 31, 2016, there were no material changes to our unrecognized tax benefits, and we do not expect to have any significant changes to unrecognized tax benefits through the end of the fiscal year. Because of our history of tax losses, all years remain open to tax audit.

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(10) Net Loss Per Share

Basic net loss per share is computed by dividing the net loss by the weighted-average number of shares of common stock outstanding during the period, less the weighted-average unvested common stock subject to repurchase or forfeiture. Diluted net loss per share is computed by giving effect to all potential shares of common stock, including preferred stock, stock options, RSUs, PSUs and RSAs to the extent dilutive.

The following table sets forth the computation of historical basic and diluted net loss per share (in thousands, except per share data):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2016	2015	2016	2015
Numerator:				
Net loss	$(93,491)	$(72,974)	$(280,984)	$(199,449)
Denominator:				
Weighted-average common shares outstanding	135,077	129,040	133,613	126,541
Less: Weighted-average unvested common shares subject to repurchase or forfeiture	(400)	(672)	(340)	(7)
Weighted-average shares used to compute net loss per share, basic and diluted	134,677	128,368	133,273	126,534
Net loss per share, basic and diluted	$(0.69)	$(0.57)	$(2.11)	$(1.58)

Since we were in a net loss position for all periods presented, basic net loss per share is the same as diluted net loss per share for all periods as the inclusion of all potential common shares outstanding would have been anti-dilutive. Potentially dilutive securities that were not included in the diluted per share calculations because they would be anti-dilutive were as follows (in thousands):

	As of October 31,	
	2016	2015
Shares subject to outstanding common stock options	2,344	4,031
Shares subject to outstanding RSUs, PSUs and RSAs	13,178	12,757
Employee stock purchase plan	330	328
Total	15,852	17,116

(11) Related Party Transactions

Certain members of our board of directors (“Board”) serve on the board of directors of and/or are executive officers of, and, in some cases, are investors in, companies that are customers or vendors of ours. Certain of our executive officers also serve on the board of directors of companies that are customers or vendors of ours. All contracts with related parties are executed in the ordinary course of business. We recognized revenues from sales to these companies of $2.4 million and $1.2 million for the three months ended October 31, 2016 and 2015, respectively, and $4.8 million and $3.7 million for the nine months ended October 31, 2016 and 2015, respectively. We recorded no expenses related to purchases from these companies during the three months ended October 31, 2016 and $0.5 million in expenses related to purchases from these companies during the three months ended October 31, 2015. We recorded $0.2 million and $1.6 million in expenses related to purchases from these companies during the nine months ended October 31, 2016 and 2015, respectively. We had $0.1 million and $0.5 million of accounts receivable from these companies as of October 31, 2016 and January 31, 2016, respectively. There were no accounts payable to these companies as of October 31, 2016 or January 31, 2016.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q. The following discussion and analysis contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. Statements that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Forward-looking statements are often identified by the use of words such as, but not limited to, "anticipate," "believe," "can," "continue," "could," "estimate," "expect," "intend," "may," "might," "plan," "project," "seek," "should," "target," "will," "would" and similar expressions or va intended to identify forward-looking statements. Such statements include, but are not limited to, statements concerning our market opportunity, our future financial and operating results; our planned investments, particularly in our product development efforts; our planned expansion of our sales and marketing organization; our expectation that we will continue to use acquisitions to contribute to our growth objectives; our growth and product integration strategies; our continued efforts to market and sell both domestically and internationally; our expectations about seasonal trends; our expectations regarding our revenues mix; our expectations regarding our cost of revenues and gross margin; use of non-GAAP (as defined below) financial measures; our expectations regarding our operating expenses, including increases in research and development, sales and marketing, and general and administrative expenses; our expectations regarding our capital expenditures; sufficiency of cash to meet cash needs for at least the next 12 months; exposure to interest rate changes; inflation; anticipated income tax rates; our expectations regarding our leases; exposure to exchange rate fluctuations and our ability to manage such exposure; and our expected cash flows and liquidity.

These statements are based on the beliefs and assumptions of our management based on information currently available to us. Such forward-looking statements are subject to risks, uncertainties and other important factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section titled "Risk Factors" included under Part II, Item 1A below. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances that occur after the date of this report.

Overview

Splunk provides innovative software solutions that enable organizations to gain real-time operational intelligence by harnessing the value of their data. Our offerings enable users to collect, index, search, explore, monitor and analyze data regardless of format or source. Our offerings address large and diverse data sets, commonly referred to as big data, and are specifically tailored for machine data. Machine data is produced by nearly every software application and electronic device and contains a definitive, time-stamped record of various activities, such as transactions, customer and user activities, and security threats. Beyond an organization's traditional information technology ("IT") and security infrastructure, every processor-based system, including HVAC controllers, many manufacturing systems, smart electrical meters, GPS devices and radio-frequency identification tags, and many consumer-oriented systems, such as electronic wearables, mobile devices, automobiles and medical devices that contain embedded processor chips, are also continuously generating machine data. Our offerings help organizations gain value from all of these different sources and forms of machine data.

We believe the market for products that provide operational intelligence presents a substantial opportunity as data grows in volume and diversity, creating new risks, opportunities and challenges for organizations. Since our inception,

we have invested a substantial amount of resources developing our offerings to address this market, specifically with respect to machine data.

Our offerings are designed to deliver rapid return-on-investment for our customers. They generally do not require customization, long deployment cycles or extensive professional services commonly associated with traditional enterprise software applications. For Splunk Enterprise, users can simply download and install the software, typically in a matter of hours, to connect to their relevant machine data sources. Alternatively, they can sign up for our Splunk Cloud service and avoid the need to provision, deploy and manage internal infrastructure. They can also provision a compute instance on Amazon Web Services via a pre-built Amazon Machine Image, which delivers a pre-configured virtual machine instance with our Splunk Enterprise software. We also offer support, training and professional services to our customers to assist in the deployment of our software.

For Splunk Enterprise, we base our license fees on the estimated daily data indexing capacity our customers require. Prospective customers can download a free 60-day trial of Splunk Enterprise, which converts into a limited free perpetual license of up to 500 megabytes of data per day. A majority of our license revenues consist of revenues from perpetual licenses, whereby we generally recognize the license fee portion of these arrangements upfront. As a result, the timing of when we enter into large perpetual licenses may lead to fluctuations in our revenues and operating results because our expenses are largely fixed in the short-term. Additionally, we license our software under term licenses, which are generally recognized ratably over the contract term. From time to time, we also enter into transactions that are designed to enable broad adoption of our software within an enterprise, referred to as enterprise adoption agreements. These agreements often include provisions that require revenue deferral and recognition over time.

Our Splunk Cloud service delivers the core functionalities of Splunk Enterprise as a scalable, reliable cloud service. Splunk Cloud customers pay an annual subscription fee based on the combination of the volume of data indexed per day and the length of the data retention period. Our product, Hunk: Splunk Analytics for Hadoop, is a software product that enables exploration, analysis and visualization of data in Hadoop. Splunk Light provides log search and analysis that is designed and priced and packaged for small IT environments. Splunk Enterprise Security addresses emerging security threats and SIEM use cases through monitoring, alerts and analytics. Splunk User Behavior Analytics detects cyber-attacks and insider threats using data science, machine learning and advanced correlation. Splunk IT Service Intelligence monitors the health and key performance indicators of critical IT services.

We intend to continue investing for long-term growth. We have invested and expect to continue to invest heavily in our product development efforts to deliver additional compelling features, address customer needs and enable solutions that can address new end markets. For example, during fiscal 2017, we released new versions of our existing products such as Splunk Enterprise and Splunk Enterprise Security. In addition, we expect to continue to aggressively expand our sales and marketing organizations to market and sell our software both in the United States and internationally. We have utilized and expect to continue to utilize acquisitions to contribute to our long-term growth objectives. In June 2015, we acquired Metafor Software, a privately-held British Columbia corporation, which developed technology that provides anomaly detection and behavioral analytics for IT operations. In July 2015, we acquired Caspida, a privately-held Delaware corporation, which developed technology that provides behavioral analytics to help detect, respond to and mitigate advanced security and insider security threats.

Our goal is to make our software the platform for delivering operational intelligence and real-time business insights from machine data. The key elements of our growth strategy are to:

- Extend our technological capabilities.
- Continue to expand our direct and indirect sales organization, including our channel relationships, to increase our sales capacity and enable greater market presence.
- Further penetrate our existing customer base and drive enterprise-wide adoption.
- Enhance our value proposition through a focus on solutions which address core and expanded use cases.
- Grow our user communities and partner ecosystem to increase awareness of our brand, target new use cases, drive operational leverage and deliver more targeted, higher value solutions.
- Continue to deliver a rich developer environment to enable rapid development of enterprise applications that leverage machine data and the Splunk platform.

We believe the factors that will influence our ability to achieve our goals include, among other things, our ability to deliver new products as well as additional product functionality; acquire new customers across geographies and industries; cultivate incremental sales from our existing customers by driving increased use of our software within organizations; provide additional solutions that leverage our core machine data platform to help organizations understand and realize the value of their machine data in specific end markets and use cases; add additional OEM and strategic relationships to enable new sales channels for our software as well as extend our integration with third party products; help software developers leverage the functionality of our machine data platform through software development kits and application programming interfaces; and successfully identify, acquire and integrate complementary businesses and technologies.

Financial Summary

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For the three months ended October 31, 2016 and 2015, our total revenues were $244.8 million and $174.4 million, respectively. For the three months ended October 31, 2016 and 2015, approximately 22% and 23% of our total revenues, respectively, were derived from customers located outside the United States. Our customers and end-users represent the public sector and a wide variety of industries, including financial services, manufacturing, retail and technology, among others. As of October 31, 2016, we had over 12,000 customers, including 85 or more of the Fortune 100 companies.

For the three months ended October 31, 2016 and 2015, our GAAP operating loss was $91.0 million and $72.3 million, respectively. Our non-GAAP operating income was $16.7 million and $6.6 million for the three months ended October 31, 2016 and 2015, respectively.

For the three months ended October 31, 2016 and 2015, our GAAP net loss was $93.5 million and $73.0 million, respectively. Our non-GAAP net income was $16.3 million and $6.0 million for the three months ended October 31, 2016 and 2015, respectively.

Our quarterly results reflect seasonality in the sale of our offerings. Historically, a pattern of increased license sales in the fourth fiscal quarter as a result of industry buying patterns has positively impacted sales activity in that period, which can result in lower sequential revenues in the following first fiscal quarter. Our gross margins and operating losses have been affected by these historical trends because the majority of our expenses are relatively fixed in the short-term. The majority of our expenses are personnel-related and include salaries, stock-based compensation, benefits and incentive-based compensation plan expenses. As a result, we have not experienced significant seasonal fluctuations in the timing of expenses from period to period.

Non-GAAP Financial Results

To supplement our condensed consolidated financial statements, which are prepared and presented in accordance with GAAP, we provide investors with certain non-GAAP financial measures, including non-GAAP cost of revenues, non-GAAP gross margin, non-GAAP research and development expense, non-GAAP sales and marketing expense, non-GAAP general and administrative expense, non-GAAP operating income (loss), non-GAAP operating margin, non-GAAP net income (loss) and non-GAAP net income (loss) per share (collectively the “non-GAAP financial measures”). These non-GAAP financial measures exclude all or a combination of the following (as reflected in the following reconciliation tables): stock-based compensation expense, employer payroll tax expense related to employee stock plans, amortization of acquired intangible assets, acquisition-related costs, adjustments related to a financing lease obligation and the partial release of the valuation allowance due to acquisition. The adjustments for the financing lease obligation are to reflect the expense we would have recorded if our build-to-suit lease arrangement had been deemed an operating lease instead of a financing lease and is calculated as the net of actual ground lease expense, depreciation and interest expense over estimated straight-line rent expense. In addition, non-GAAP financial measures include free cash flow, which represents cash from operations less purchases of property and equipment. The presentation of the non-GAAP financial measures is not intended to be considered in isolation or as a substitute for, or superior to, the financial information prepared and presented in accordance with GAAP. We use these non-GAAP financial measures for financial and operational decision-making purposes and as a means to evaluate period-to-period comparisons. We believe that these non-GAAP financial measures provide useful information about our operating results, enhance the overall understanding of past financial performance and future prospects and allow for greater transparency with respect to key metrics used by management in our financial and operational decision making. In addition, these non-GAAP financial measures facilitate comparisons to competitors’ operating results.

We exclude stock-based compensation expense because it is non-cash in nature and excluding this expense provides meaningful supplemental information regarding our operational performance. In particular, because of varying available valuation methodologies, subjective assumptions and the variety of award types that companies can use

under FASB ASC Topic 718, we believe that providing non-GAAP financial measures that exclude this expense allows investors the ability to make more meaningful comparisons between our operating results and those of other companies. We exclude employer payroll tax expense related to employee stock plans in order for investors to see the full effect that excluding that stock-based compensation expense had on our operating results. These expenses are tied to the exercise or vesting of underlying equity awards and the price of our common stock at the time of vesting or exercise, which may vary from period to period independent of the operating performance of our business. We also exclude amortization of acquired intangible assets, acquisition-related costs, the partial release of the valuation allowance due to acquisition and make adjustments related to a financing lease obligation from our non-GAAP financial measures because these are considered by management to be outside of our core operating results. Accordingly, we believe that excluding these expenses provides investors and management with greater visibility to the underlying performance of our business operations, facilitates comparison of our results with other periods and may also facilitate comparison with the results of other companies in our industry. We consider free cash flow to be a liquidity measure that provides useful information to management and investors about the amount of cash generated by the

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business that can be used for strategic opportunities, including investing in our business, making strategic acquisitions and strengthening our balance sheet.

There are limitations in using non-GAAP financial measures because the non-GAAP financial measures are not prepared in accordance with GAAP, may be different from non-GAAP financial measures used by our competitors and exclude expenses that may have a material impact upon our reported financial results. Further, stock-based compensation expense has been and will continue to be for the foreseeable future a significant recurring expense in our business and an important part of the compensation provided to our employees. The non-GAAP financial measures are meant to supplement and be viewed in conjunction with GAAP financial measures.

The following table reconciles our net cash provided by operating activities to free cash flow for the three and nine months ended October 31, 2016, and 2015 (in thousands):

	Three Months Ended		Nine Months Ended	
	October 31, 2016	October 31, 2015	October 31, 2016	October 31, 2015
Net cash provided by operating activities	$45,272	$36,360	$99,310	$78,613
Less purchases of property and equipment	(12,969)	(15,272)	(27,219)	(24,496)
Free cash flow (Non-GAAP)	$32,303	$21,088	$72,091	$54,117
Net cash provided by (used in) investing activities	$(64,224)	$136,873	$(108,227)	$11,261
Net cash provided by (used in) financing activities	$(25,257)	$2,303	$(50,266)	$24,597

The following table reconciles our GAAP to Non-GAAP Financial Measures for the three months ended October 31, 2016 (in thousands, except per share amounts):

	GAAP	Stock-based compensation	Employer payroll tax on employee stock plans	Amortization of acquired intangible assets	Adjustments related to financing lease obligation	Non-GAAP
Cost of revenues	$48,674	$ (7,610)	$(130)	$ (2,814)	$ 276	$38,396
Gross Margin	80.1%	3.1%	0.1%	1.1%	(0.1)%	84.3%
Research and development	85,659	(45,355)	(534)	(63)	559	40,266
Sales and marketing	167,330	(38,750)	(712)	(110)	1,124	128,882
General and administrative	34,079	(13,299)	(504)	—	236	20,512
Operating income (loss)	(90,953)	105,014	1,880	2,987	(2,195)	16,733
Operating margin	(37.2)%	42.9%	0.8%	1.2%	(0.9)%	6.8%
Net income (loss)	$(93,491)	$ 105,014	$1,880	$ 2,987	$ (123) [2]	$16,267
Net income (loss) per share[1]	$(0.69)					$0.12

[1] GAAP net loss per share calculated based on 134,677 weighted-average shares of common stock. Non-GAAP net income per share calculated based on 138,401 diluted weighted-average shares of common stock, which includes 3,724 potentially dilutive shares related to employee stock awards. GAAP to Non-GAAP net income (loss) per share is not reconciled due to the difference in the number of shares used to calculate basic and diluted weighted-average shares of common stock.
[2] Includes $2.1 million of interest expense related to the financing lease obligation.

The following table reconciles our GAAP to Non-GAAP Financial Measures for the three months ended October 31, 2015 (in thousands, except per share amounts):

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	GAAP	Stock-based compensation	Employer payroll tax on employee stock plans	Amortization of acquired intangible assets	Adjustments related to financing lease obligation	Non-GAAP
Cost of revenues	$30,591	$ (6,384)	$(145)	$ (2,896)	$ —	$21,166
Gross Margin	82.5%	3.6%	0.1%	1.7%	—%	87.9%
Research and development	56,186	(22,534)	(510)	(86)	—	33,056
Sales and marketing	130,131	(33,247)	(501)	(164)	—	96,219
General and administrative	29,857	(11,999)	(283)	—	(222)	17,353
Operating income (loss)	(72,345)	74,164	1,439	3,146	222	6,626
Operating margin	(41.5)%	42.5%	0.8%	1.9%	0.1%	3.8%
Net income (loss)	$(72,974)	$ 74,164	$1,439	$ 3,146	$ 222	$5,997
Net income (loss) per share[1]	$(0.57)					$0.05

[1] GAAP net loss per share calculated based on 128,368 weighted-average shares of common stock. Non-GAAP net income per share calculated based on 132,675 diluted weighted-average shares of common stock, which includes 4,307 potentially dilutive shares related to employee stock awards. GAAP to Non-GAAP net income (loss) per share is not reconciled due to the difference in the number of shares used to calculate basic and diluted weighted-average shares of common stock.

The following table reconciles our GAAP to Non-GAAP Financial Measures for the nine months ended October 31, 2016 (in thousands, except per share amounts):

	GAAP	Stock-based compensation	Employer payroll tax on employee stock plans	Amortization of acquired intangible assets	Adjustments related to financing lease obligation	Non-GAAP
Cost of revenues	$132,790	$ (22,475)	$(600)	$ (8,612)	$ 561	$101,664
Gross Margin	79.4%	3.5%	0.1%	1.3%	(0.1)%	84.2%
Research and development	220,254	(102,303)	(1,966)	(193)	1,172	116,964
Sales and marketing	462,709	(118,354)	(2,529)	(412)	2,373	343,787
General and administrative	100,464	(42,115)	(1,333)	—	513	57,529
Operating income (loss)	(272,723)	285,247	6,428	9,217	(4,619)	23,550
Operating margin	(42.4)%	44.4%	1.0%	1.4%	(0.7)%	3.7%
Net income (loss)	$(280,984)	$ 285,247	$6,428	$ 9,217	$ 994 [2]	$20,902
Net income (loss) per share[1]	$(2.11)					$0.15

[1] GAAP net loss per share calculated based on 133,273 weighted-average shares of common stock. Non-GAAP net income per share calculated based on 136,690 diluted weighted-average shares of common stock, which includes 3,417 potentially dilutive shares related to employee stock awards. GAAP to Non-GAAP net income (loss) per share is not reconciled due to the difference in the number of shares used to calculate basic and diluted weighted-average shares of common stock.
[2] Includes $5.6 million of interest expense related to the financing lease obligation.

The following table reconciles our GAAP to Non-GAAP Financial Measures for the nine months ended October 31, 2015 (in thousands, except per share amounts):

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	GAAP	Stock-based compensation	Employer payroll tax on employee stock plans	Amortization of acquired intangible assets	Acquisition-related costs and income tax effects	Adjustments related to financing lease obligation	Non-GAAP
Cost of revenues	$78,716	$(18,578)	$(806)	$(5,379)	$ —	$ —	$53,953
Gross Margin	82.4 %	4.2 %	0.2 %	1.2 %	— %	— %	88.0 %
Research and development	149,192	(61,910)	(2,145)	(234)	—	—	84,903
Sales and marketing	343,906	(91,067)	(2,562)	(469)	—	—	249,808
General and administrative	85,489	(32,327)	(1,465)	—	(1,993)	(666)	49,038
Operating income (loss)	(208,892)	203,882	6,978	6,082	1,993	666	10,709
Operating margin	(46.6)%	45.5 %	1.6 %	1.4 %	0.4 %	0.1 %	2.4 %
Net income (loss)	$(199,449)	$203,882	$6,978	$6,082	$ (8,931) [(2)]	$ 666	$9,228
Net income (loss) per share[(1)]	$(1.58)						$0.07

(1) GAAP net loss per share calculated based on 126,534 weighted-average shares of common stock. Non-GAAP net income per share calculated based on 131,693 diluted weighted-average shares of common stock, which includes 5,159 potentially dilutive shares related to employee stock awards. GAAP to Non-GAAP net income (loss) per share is not reconciled due to the difference in the number of shares used to calculate basic and diluted weighted-average shares of common stock.
(2) Includes $10.9 million related to the partial release of the valuation allowance due to acquisition.

Components of Operating Results

Revenues

License revenues. License revenues reflect the revenues recognized from sales of licenses to new customers and additional licenses to existing customers. We are focused on acquiring new customers and increasing revenues from our existing customers as they realize the value of our software by indexing higher volumes of machine data and expanding the use of our software through additional use cases and broader deployment within their organizations. A majority of our license revenues consists of revenues from perpetual licenses, under which we generally recognize the license fee portion of the arrangement upfront, assuming all revenue recognition criteria are satisfied. Customers can also purchase term license agreements, under which we recognize the license fee ratably, on a straight-line basis, over the term of the license. Due to the differing revenue recognition policies applicable to perpetual and term licenses, shifts in the mix between perpetual and term licenses from quarter to quarter could produce substantial variation in revenues recognized even if our sales remain consistent. In addition, seasonal trends that contribute to increased sales activity in the fourth fiscal quarter often result in lower sequential revenues in the first fiscal quarter, and we expect this trend to continue. Comparing our revenues on a period-to-period basis may not be meaningful, and you should not rely on our past results as an indication of our future performance.

Maintenance and services revenues. Maintenance and services revenues consist of revenues from maintenance agreements and, to a lesser extent, professional services and training, as well as revenues from our cloud services. Typically, when purchasing a perpetual license, a customer also purchases one year of maintenance service for which we charge a percentage of the license fee. When a term license is purchased, maintenance service is typically bundled with the license for the term of the license period. Customers with maintenance agreements are entitled to receive

support and unspecified upgrades and enhancements when and if they become available during the maintenance period. We recognize the revenues associated with maintenance agreements ratably, on a straight-line basis, over the associated maintenance period. In arrangements involving a term license, we recognize both the license and maintenance revenues over the contract period. We have a professional services organization focused on helping some of our largest customers deploy our software in highly complex operational environments and train their personnel. We recognize the revenues associated with these professional services on a time and materials basis as we deliver the services or provide the training. We expect maintenance and services revenues to become a larger percentage of our total revenues as our installed customer base grows. We generally recognize the revenues associated with our cloud services ratably, on a straight-line basis, over the associated subscription term.

Professional services and training revenues, as a percentage of total revenues, were 9% and 8% for the three months ended October 31, 2016 and 2015, respectively. We have experienced continued growth in our professional services revenues primarily due to the deployment of our software with some customers that have large, highly complex IT environments.

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Cost of Revenues