

SALESFORCE COM INC  
Form 10-Q  
August 25, 2017  
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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 July 31, 2017

OR

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
Commission File Number: 001-32224

salesforce.com, inc.  
(Exact name of registrant as specified in its charter)

Delaware 94-3320693  
(State or other jurisdiction of (IRS Employer  
incorporation or organization) Identification No.)  
The Landmark @ One Market, Suite 300  
San Francisco, California 94105  
(Address of principal executive offices)  
Telephone Number (415) 901-7000  
(Registrant’s telephone number, including area code)

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

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

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

Large accelerated filer  Accelerated filer

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

Emerging growth company

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

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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 July 31, 2017, there were approximately 718.7 million shares of the Registrant's Common Stock outstanding.

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

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Consolidated Balance Sheets

(in thousands)

|   | July 31,<br>2017<br>(unaudited) | January 31,<br>2017 |
|---|---------------------------------|---------------------|
| Assets  |                                 |                     |
| Current assets:   |                                 |                     |
| Cash and cash equivalents                                     | \$1,949,110                     | \$1,606,549         |
| Marketable securities   | 1,552,135                       | 602,338             |
| Accounts receivable, net                                      | 1,569,322                       | 3,196,643           |
| Deferred commissions  | 302,528                         | 311,770             |
| Prepaid expenses and other current assets                     | 438,246                         | 279,527             |
| Total current assets  | 5,811,341                       | 5,996,827           |
| Property and equipment, net                                   | 1,866,576                       | 1,787,534           |
| Deferred commissions, noncurrent                              | 224,232                         | 227,849             |
| Capitalized software, net                                     | 140,703                         | 141,671             |
| Strategic investments   | 657,687                         | 566,953             |
| Goodwill  | 7,294,381                       | 7,263,846           |
| Intangible assets acquired through business combinations, net | 965,887                         | 1,113,374           |
| Other assets, net   | 457,996                         | 486,869             |
| Total assets  | \$17,418,803                    | \$17,584,923        |
| Liabilities, temporary equity and stockholders' equity        |                                 |                     |
| Current liabilities:  |                                 |                     |
| Accounts payable, accrued expenses and other liabilities      | \$1,576,822                     | \$1,752,664         |
| Deferred revenue  | 4,818,634                       | 5,542,802           |
| Convertible 0.25% senior notes, net                           | 1,130,729                       | 0                   |
| Total current liabilities                                     | 7,526,185                       | 7,295,466           |
| Convertible 0.25% senior notes, net                           | 0                               | 1,116,360           |
| Term loan   | 497,796                         | 497,221             |
| Loan assumed on 50 Fremont                                    | 198,403                         | 198,268             |
| Revolving credit facility                                     | 0                               | 196,542             |
| Other noncurrent liabilities                                  | 727,882                         | 780,939             |
| Total liabilities   | 8,950,266                       | 10,084,796          |
| Temporary equity:   |                                 |                     |
| Convertible 0.25% senior notes (See Note 8)                   | 17,223                          | 0                   |
| Stockholders' equity:   |                                 |                     |
| Common stock  | 719                             | 708                 |
| Additional paid-in capital                                    | 8,889,441                       | 8,040,170           |
| Accumulated other comprehensive income (loss)                 | 17,535                          | (75,841 )           |
| Accumulated deficit   | (456,381 )                      | (464,910 )          |
| Total stockholders' equity                                    | 8,451,314                       | 7,500,127           |
| Total liabilities, temporary equity and stockholders' equity  | \$17,418,803                    | \$17,584,923        |

See accompanying Notes.

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Consolidated Statements of Operations

(in thousands, except per share data)

(unaudited)

|   | Three Months Ended July 31, |             | Six Months Ended July 31, |             |
|---|-----------------------------|-------------|---------------------------|-------------|
|   | 2017                        | 2016        | 2017                      | 2016        |
| Revenues:   |                             |             |                           |             |
| Subscription and support                                | \$2,368,499                 | \$1,886,080 | \$4,569,407               | \$3,661,573 |
| Professional services and other                         | 193,090                     | 150,538     | 379,761                   | 291,648     |
| Total revenues  | 2,561,589                   | 2,036,618   | 4,949,168                 | 3,953,221   |
| Cost of revenues (1)(2):                                |                             |             |                           |             |
| Subscription and support                                | 493,879                     | 376,456     | 956,800                   | 727,557     |
| Professional services and other                         | 176,788                     | 149,123     | 364,422                   | 295,003     |
| Total cost of revenues                                  | 670,667                     | 525,579     | 1,321,222                 | 1,022,560   |
| Gross profit  | 1,890,922                   | 1,511,039   | 3,627,946                 | 2,930,661   |
| Operating expenses (1)(2):                              |                             |             |                           |             |
| Research and development                                | 386,447                     | 291,506     | 762,528                   | 552,476     |
| Marketing and sales                                     | 1,170,749                   | 934,931     | 2,280,253                 | 1,830,791   |
| General and administrative                              | 282,933                     | 252,051     | 543,254                   | 462,857     |
| Total operating expenses                                | 1,840,129                   | 1,478,488   | 3,586,035                 | 2,846,124   |
| Income from operations                                  | 50,793                      | 32,551      | 41,911                    | 84,537      |
| Investment income                                       | 8,754                       | 11,916      | 14,020                    | 20,038      |
| Interest expense  | (21,629)                    | (20,708)    | (43,825)                  | (42,719)    |
| Other income (expense) (1)                              | (7,465)                     | 524         | (4,616)                   | (13,282)    |
| Gains from acquisitions of strategic investments        | 0                           | 0           | 0                         | 12,864      |
| Income before benefit from (provision for) income taxes | 30,453                      | 24,283      | 7,490                     | 61,438      |
| Benefit from (provision for) income taxes               | (12,717)                    | 205,339     | 1,039                     | 206,943     |
| Net income  | \$17,736                    | \$229,622   | \$8,529                   | \$268,381   |
| Basic net income per share                              | \$0.02                      | \$0.34      | \$0.01                    | \$0.40      |
| Diluted net income per share                            | \$0.02                      | \$0.33      | \$0.01                    | \$0.39      |
| Shares used in computing basic net income per share     | 712,039                     | 681,126     | 709,157                   | 678,929     |
| Shares used in computing diluted net income per share   | 729,386                     | 695,968     | 726,222                   | 691,714     |

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

|                             | Three Months Ended July 31, |          | Six Months Ended July 31, |          |
|-----------------------------|-----------------------------|----------|---------------------------|----------|
|                             | 2017                        | 2016     | 2017                      | 2016     |
| Cost of revenues            | \$43,483                    | \$25,544 | \$87,069                  | \$47,759 |
| Marketing and sales         | 30,563                      | 23,151   | 61,207                    | 38,537   |
| Other non-operating expense | 376                         | 642      | 751                       | 1,348    |

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

|                            | Three Months Ended July 31, |          | Six Months Ended July 31, |          |
|----------------------------|-----------------------------|----------|---------------------------|----------|
|                            | 2017                        | 2016     | 2017                      | 2016     |
| Cost of revenues           | \$32,202                    | \$23,495 | \$63,712                  | \$50,129 |
| Research and development   | 66,644                      | 38,624   | 130,559                   | 73,792   |
| Marketing and sales        | 120,550                     | 86,323   | 239,546                   | 181,797  |
| General and administrative | 37,089                      | 33,868   | 74,237                    | 65,511   |

See accompanying Notes.

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Consolidated Statements of Comprehensive Income

(in thousands)

(unaudited)

|   | Three Months Ended |           | Six Months Ended |           |
|---|--------------------|-----------|------------------|-----------|
|   | July 31,           |           | July 31,         |           |
|   | 2017               | 2016      | 2017             | 2016      |
| Net income  | \$17,736           | \$229,622 | \$8,529          | \$268,381 |
| Other comprehensive income, before tax and net of reclassification adjustments: |                    |           |                  |           |
| Foreign currency translation and other gains (losses)                           | 16,384             | (10,407 ) | 30,408           | (151 )    |
| Unrealized gains (losses) on marketable securities and strategic investments    | (8,362 )           | 25,896    | 62,968           | 36,980    |
| Other comprehensive income, before tax  | 8,022              | 15,489    | 93,376           | 36,829    |
| Tax effect  | 0                  | 1,873     | 0                | 1,873     |
| Other comprehensive income, net of tax  | 8,022              | 17,362    | 93,376           | 38,702    |
| Comprehensive income  | \$25,758           | \$246,984 | \$101,905        | \$307,083 |

See accompanying Notes.





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## Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

|   | Three Months Ended July 31, |              | Six Months Ended July 31, |              |
|---|-----------------------------|--------------|---------------------------|--------------|
|   | 2017                        | 2016         | 2017                      | 2016         |
| Operating activities:   |                             |              |                           |              |
| Net income  | \$17,736                    | \$229,622    | \$8,529                   | \$268,381    |
| Adjustments to reconcile net income to net cash provided by operating activities: |                             |              |                           |              |
| Depreciation and amortization   | 192,257                     | 149,361      | 377,365                   | 282,133      |
| Amortization of debt discount and issuance costs                                  | 7,753                       | 6,868        | 15,470                    | 14,053       |
| Gains from acquisitions of strategic investments                                  | 0                           | 0            | 0                         | (12,864 )    |
| Amortization of deferred commissions  | 107,868                     | 88,783       | 214,010                   | 177,297      |
| Expenses related to employee stock plans  | 256,485                     | 182,310      | 508,054                   | 371,229      |
| Changes in assets and liabilities, net of business combinations:                  |                             |              |                           |              |
| Accounts receivable, net  | (129,447 )                  | (73,167 )    | 1,628,060                 | 1,234,145    |
| Deferred commissions  | (116,703 )                  | (70,643 )    | (201,152 )                | (134,162 )   |
| Prepaid expenses and other current assets and other assets                        | 32,296                      | (9,728 )     | (151,115 )                | (66,399 )    |
| Accounts payable, accrued expenses and other liabilities                          | 187,042                     | (46,666 )    | (114,200 )                | (332,894 )   |
| Deferred revenue  | (224,018 )                  | (206,062 )   | (724,168 )                | (499,179 )   |
| Net cash provided by operating activities   | 331,269                     | 250,678      | 1,560,853                 | 1,301,740    |
| Investing activities:   |                             |              |                           |              |
| Business combinations, net of cash acquired                                       | 0                           | (2,798,194 ) | (19,781 )                 | (2,799,993 ) |
| Strategic investments, net  | (42,958 )                   | (390 )       | (43,416 )                 | (22,451 )    |
| Purchases of marketable securities  | (501,333 )                  | (285,795 )   | (1,199,894 )              | (875,131 )   |
| Sales of marketable securities  | 139,628                     | 1,610,724    | 243,465                   | 1,833,658    |
| Maturities of marketable securities   | 9,420                       | 27,253       | 13,270                    | 50,538       |
| Capital expenditures  | (128,388 )                  | (96,030 )    | (284,990 )                | (179,331 )   |
| Net cash used in investing activities   | (523,631 )                  | (1,542,432 ) | (1,291,346 )              | (1,992,710 ) |
| Financing activities:   |                             |              |                           |              |
| Proceeds from term loan, net  | 0                           | 495,550      | 0                         | 495,550      |
| Proceeds from employee stock plans  | 183,009                     | 133,878      | 342,816                   | 223,019      |
| Principal payments on capital lease obligations                                   | (65,731 )                   | (12,795 )    | (75,174 )                 | (62,763 )    |
| Payments on revolving credit facility   | 0                           | 0            | (200,000 )                | 0            |
| Net cash provided by financing activities   | 117,278                     | 616,633      | 67,642                    | 655,806      |
| Effect of exchange rate changes   | (710 )                      | (8,736 )     | 5,412                     | (7,973 )     |
| Net increase (decrease) in cash and cash equivalents                              | (75,794 )                   | (683,857 )   | 342,561                   | (43,137 )    |
| Cash and cash equivalents, beginning of period                                    | 2,024,904                   | 1,799,083    | 1,606,549                 | 1,158,363    |
| Cash and cash equivalents, end of period  | \$1,949,110                 | \$1,115,226  | \$1,949,110               | \$1,115,226  |
| See accompanying Notes.   |                             |              |                           |              |

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Consolidated Statements of Cash Flows

Supplemental Cash Flow Disclosure

(in thousands)

(unaudited)

|  | Three Months<br>Ended July 31, |          | Six Months Ended<br>July 31, |           |
|--|--------------------------------|----------|------------------------------|-----------|
|  | 2017                           | 2016     | 2017                         | 2016      |
| Supplemental cash flow disclosure:   |                                |          |                              |           |
| Cash paid during the period for:   |                                |          |                              |           |
| Interest   | \$20,543                       | \$6,285  | \$27,265                     | \$30,035  |
| Income taxes, net of tax refunds   | \$9,335                        | \$6,322  | \$26,682                     | \$14,231  |
| Non-cash investing and financing activities:                                 |                                |          |                              |           |
| Fixed assets acquired under capital leases                                   | \$0                            | \$0      | \$2,471                      | \$585     |
| Fair value of equity awards assumed  | \$0                            | \$9,344  | \$0                          | \$20,793  |
| Fair value of common stock issued as consideration for business combinations | \$0                            | \$0      | \$6,193                      | \$278,372 |
| Non-cash equity liability (See Note 9)                                       | \$5,476                        | \$76,043 | \$12,961                     | \$76,043  |

See accompanying Notes.

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Notes to Consolidated Financial Statements

1. Summary of Business and Significant Accounting Policies

Description of Business

Salesforce.com, inc. ("the Company") is a leading provider of enterprise software, delivered through the cloud, with a focus on customer relationship management, or CRM. The Company introduced its first CRM solution in 2000, and has since expanded its service offerings into new areas and industries with new editions, features and platform capabilities.

The Company's core mission is to empower its customers to connect with their customers in entirely new ways through cloud, mobile, social, Internet of Things ("IoT") and artificial intelligence technologies.

The Company's Customer Success Platform is a comprehensive portfolio of service offerings providing sales force automation, customer service and support, marketing automation, digital commerce, community management, analytics, application development, IoT integration, collaborative productivity tools and its professional cloud services.

Fiscal Year

The Company's fiscal year ends on January 31. References to fiscal 2018, for example, refer to the fiscal year ending January 31, 2018.

Basis of Presentation

The accompanying consolidated balance sheet as of July 31, 2017 and the consolidated statements of operations, the consolidated statements of comprehensive income and the consolidated statements of cash flows for the three and six months ended July 31, 2017 and 2016, respectively, are unaudited.

These financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") for interim financial information. Accordingly, they do not include all of the financial information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of the Company's management, the unaudited consolidated financial statements include all adjustments necessary for the fair presentation of the Company's balance sheet as of July 31, 2017, and its results of operations, including its comprehensive income, and its cash flows for the three and six months ended July 31, 2017 and 2016. All adjustments are of a normal recurring nature. The results for the three and six months ended July 31, 2017 are not necessarily indicative of the results to be expected for any subsequent quarter or for the fiscal year ending January 31, 2018.

These unaudited interim consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 2017, filed with the Securities and Exchange Commission (the "SEC") on March 6, 2017.

Use of Estimates

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

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

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

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

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## Principles of Consolidation

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

## Segments

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

## Concentrations of Credit Risk and Significant Customers

The Company's financial instruments that are exposed to concentrations of credit risk consist primarily of cash and cash equivalents, marketable securities and accounts receivable. In addition, in connection with the Company's 0.25% Senior Notes (as defined in Note 8 "Debt"), the Company entered into convertible note hedge transactions with respect to its common stock which are exposed to concentrations of credit risk. Collateral is not required for accounts receivable or the note hedge transactions. The Company maintains an allowance for its doubtful accounts receivable. This allowance is based upon historical loss patterns, the number of days that billings are past due and an evaluation of the potential risk of loss associated with delinquent accounts. Receivables are written-off and charged against its recorded allowance when the Company has exhausted collection efforts without success.

No single customer accounted for more than five percent of accounts receivable at July 31, 2017 and January 31, 2017. No single customer accounted for five percent or more of total revenue during the three and six months ended July 31, 2017 and 2016.

## Geographic Locations

As of July 31, 2017 and January 31, 2017, assets located outside the Americas were 13 percent and 12 percent of total assets, respectively. As of July 31, 2017 and January 31, 2017, assets located in the United States were 85 percent and 86 percent of total assets, respectively.

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

|              | Three Months Ended |             | Six Months Ended July |             |
|--------------|--------------------|-------------|-----------------------|-------------|
|              | July 31,           |             | 31,                   |             |
|              | 2017               | 2016        | 2017                  | 2016        |
| Americas     | \$1,854,169        | \$1,495,201 | \$3,609,527           | \$2,908,430 |
| Europe       | 464,371            | 347,320     | 873,986               | 675,174     |
| Asia Pacific | 243,049            | 194,097     | 465,655               | 369,617     |
|              | \$2,561,589        | \$2,036,618 | \$4,949,168           | \$3,953,221 |

Revenues by geography are determined based on the region of the Salesforce contracting entity, which may be different than the region of the customer. Americas revenue attributed to the United States was approximately 96 percent during the three and six months ended July 31, 2017 and 2016. No other country represented more than ten percent of total revenue during the three and six months ended July 31, 2017 and 2016.

## Revenue Recognition

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



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

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

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

### Subscription and Support Revenues

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

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

### Professional Services and Other Revenues

The Company's professional services contracts are either on a time and materials, fixed fee or subscription basis. These revenues are recognized as the services are rendered for time and materials contracts, when the milestones are achieved and accepted by the customer or on a proportional performance basis for fixed price contracts and ratably over the contract term for subscription professional services contracts. The milestone method for revenue recognition is used when there is substantive uncertainty at the date the contract is entered into whether the milestone will be achieved. Training revenues are recognized as the services are performed.

### Multiple Deliverable Arrangements

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

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

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

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

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

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### Deferred Revenue

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

### Deferred Commissions

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

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

During the six months ended July 31, 2017, the Company deferred \$201.2 million of commission expenditures and amortized \$214.0 million to sales expense. During the same period a year ago, the Company deferred \$134.2 million of commission expenditures and amortized \$177.3 million to sales expense. Deferred commissions on the Company's consolidated balance sheets totaled \$526.8 million at July 31, 2017 and \$539.6 million at January 31, 2017.

### Cash and Cash Equivalents

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

### Marketable Securities

The Company considers all of its marketable debt securities as available for use in current operations, including those with maturity dates beyond one year, and therefore classifies these securities within current assets on the consolidated balance sheets. Securities are classified as available for sale and are carried at fair value, with the change in unrealized gains and losses, net of tax, reported as a separate component on the consolidated statements of comprehensive income until realized. 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 reduction to investment income. In order to determine whether a decline in value is other-than-temporary, the Company evaluates, among other factors: the duration and extent to which the fair value has been less than the carrying value and its intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in fair value. For the purposes of computing realized and unrealized gains and losses, the cost of securities sold is based on the specific-identification method. Interest on securities classified as available for sale is also included as a component of investment income.

### Strategic Investments

The Company holds certain marketable equity and non-marketable debt and equity securities within its strategic investments portfolio. Marketable equity securities are measured using quoted prices in their respective active markets, non-marketable debt securities are recorded at their estimated fair value and the non-marketable equity securities are recorded at cost.

Marketable equity securities and non-marketable debt securities, which consist of noncontrolling debt investments in privately held companies, are recorded at fair value with changes in fair value recorded through accumulated other comprehensive income. Equity investments without readily determinable fair values for which the Company does not have the ability to exercise significant influence are accounted for using the cost method of accounting. Under the cost method of accounting, the non-marketable securities are carried at cost and are adjusted only for other-than-temporary impairments, certain distributions and additional investments. These investments are valued using significant



unobservable inputs or data in an inactive market and the valuation requires the Company's judgment due to the absence of market prices and inherent lack of

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liquidity. The estimated fair value is based on quantitative and qualitative factors including, but not limited to, subsequent financing activities by the investee and projected discounted cash flows. Fair value is not estimated for non-marketable equity securities if there are no identified events or changes in circumstances that may have an effect on the fair value of the investment.

The carrying value of the Company's strategic investments is impacted by various events such as entering into new investments, dispositions due to acquisitions, fair market value adjustments or initial public offerings. The cash inflows from exits and cash outflows for new investments are disclosed as strategic investments within the investing activities section of the statement of cash flows and any gains or losses are recorded within the operating activities of the statements of cash flows for each of the respective fiscal quarter periods.

**Derivative Financial Instruments**

The Company enters into foreign currency derivative contracts with financial institutions to reduce foreign exchange risk. The Company uses forward currency derivative contracts to minimize the Company's exposure to balances primarily denominated in the Euro, British Pound Sterling, Japanese Yen, Canadian Dollar and Australian Dollar. The Company's foreign currency derivative contracts, which are not designated as hedging instruments, are used to reduce the exchange rate risk associated primarily with intercompany receivables and payables. The Company's derivative financial instruments program is not designated for trading or speculative purposes. As of July 31, 2017 and January 31, 2017, the foreign currency derivative contracts that were not settled were recorded at fair value on the consolidated balance sheets.

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

**Fair Value Measurement**

The Company measures its cash and cash equivalents, marketable securities and foreign currency derivative contracts at fair value. The additional disclosures regarding the Company's fair value measurements are included in Note 4 "Fair Value Measurement."

**Property and Equipment**

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

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

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

**Capitalized Software Costs**

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

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### Intangible Assets acquired through Business Combinations

Intangible assets are amortized over their estimated useful lives. Each period, the Company evaluates the estimated remaining useful life of its intangible assets and whether events or changes in circumstances warrant a revision to the remaining period of amortization.

### Impairment Assessment

The Company evaluates intangible assets and long-lived assets for possible impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. This includes but is not limited to significant adverse changes in business climate, market conditions, or other events that indicate an asset's carrying amount may not be recoverable. Recoverability of these assets is measured by comparing the carrying amount of each asset to the future undiscounted cash flows the asset is expected to generate. If the undiscounted cash flows used in the test for recoverability are less than the carrying amount of these assets, the carrying amount of such assets is reduced to fair value.

The Company evaluates and tests the recoverability of its goodwill for impairment at least annually during its fourth quarter of each fiscal year or more often if and when circumstances indicate that goodwill may not be recoverable. There was no impairment of intangible assets, long-lived assets or goodwill during the three and six months ended July 31, 2017 and 2016.

### Business Combinations

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

In the event the Company acquires an entity with which the Company has a preexisting relationship, the Company will recognize a gain or loss to settle that relationship as of the acquisition date, which is recorded in other income (expense) within the statements of operations. In the event that the Company acquires an entity in which the Company previously held a strategic investment, the difference between the fair value of the shares as of the date of the acquisition and the carrying value of the strategic investment is recorded as a gain or loss and disclosed separately within the statements of operations.

### Leases and Asset Retirement Obligations

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

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

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

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

recorded in other income (expense).

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### Accounting for Stock-Based Expense

The Company recognizes stock-based expenses related to stock options and restricted stock awards on a straight-line basis, net of forfeitures, over the requisite service period of the awards, which is generally the vesting term of four years. The Company recognizes stock-based expenses related to shares issued pursuant to its Amended and Restated 2004 Employee Stock Purchase Plan (“ESPP” or “2004 Employee Stock Purchase Plan”) on a straight-line basis over the offering period, which is 12 months.

Stock-based expenses related to performance share grants are measured based on grant date fair value and expensed on a straight-line basis over the service period of the awards, which is generally the vesting term of three years.

The Company, at times, grants unvested restricted shares to employee stockholders of certain acquired companies in lieu of cash consideration. These awards are generally subject to continued post-acquisition employment. Therefore, the Company accounts for them as post-acquisition stock-based expense. The Company recognizes stock-based expense equal to the grant date fair value of the restricted stock awards on a straight-line basis over the requisite service period of the awards, which is generally four years.

### Income Taxes

The Company uses the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on temporary differences between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect on deferred tax assets and liabilities of a change in tax laws is recognized in the consolidated statements of operations in the period that includes the enactment date.

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

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

### Foreign Currency Translation

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

### Warranties and Indemnification

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

The Company’s arrangements generally include certain provisions for indemnifying customers against liabilities if its products or services infringe a third party’s intellectual property rights. To date, the Company has not incurred any

material costs as a result of such obligations and has not accrued any material liabilities related to such obligations in the accompanying consolidated financial statements.

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

**New Accounting Pronouncements Adopted in Fiscal 2018**

In January 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2017-01, "Business Combinations (Topic 805) Clarifying the Definition of a Business" ("ASU 2017-01") which amended the existing FASB Accounting Standards Codification. The standard provides additional guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The definition of a business affects many areas of accounting, including acquisitions, disposals, goodwill, and consolidation. ASU 2017-01 is effective for fiscal 2019 with early adoption permitted. The Company early adopted the standard in the first quarter of fiscal 2018 on a prospective basis. Since the Company has not acquired any material businesses since the start of the year, this standard has had no impact on the Company's financial statements. In May 2017, the FASB issued Accounting Standards Update No. 2017-09, "Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting" ("ASU 2017-09") which amended the existing FASB Accounting Standards Codification. The standard provides clarity and reduces the cost and complexity when applying the guidance in Topic 718, Compensation—Stock Compensation, to a change to the terms or conditions of a share-based payment award. ASU 2017-09 is effective for fiscal 2019 with early adoption permitted. The Company early adopted the standard in the second quarter of fiscal 2018 on a prospective basis and does not expect it to have any impact on the Company's financial statements.

**Pending Accounting Pronouncements**

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, "Revenue from Contracts with Customers (Topic 606)" ("ASU 2014-09"), which amended the existing FASB Accounting Standards Codification, replaces existing revenue recognition guidance with a comprehensive revenue measurement and recognition standard and expanded disclosure requirements. The standard also provides guidance on the recognition of costs related to obtaining customer contracts. ASU 2014-09, as amended, will be effective for the beginning of fiscal 2019, including interim periods within that reporting period.

The Company currently anticipates adopting the standard using the full retrospective method to restate each prior reporting period presented. The Company's ability to adopt this standard using the full retrospective method is dependent upon system readiness for both revenue and commissions and the completion of the analysis of information necessary to restate prior period financial statements.

The Company is continuing to assess the impact of adopting ASU 2014-09 on its financial position, results of operations and related disclosures and has not yet determined whether the effect of the revenue portion will be material. Additionally, as the Company continues to assess the new standard along with industry trends and additional interpretive guidance, the Company may adjust its implementation plan accordingly.

The Company believes that the new standard will impact the following policies and disclosures:

- removal of the current limitation on contingent revenue will result in revenue being recognized earlier for certain contracts;
- allocation of subscription and support revenue across different clouds and to professional services revenue;
- estimation of variable consideration for arrangements with overage fees;
- required disclosures including information about the remaining transaction price and when the Company expects to recognize revenue; and
- accounting for deferred commissions including costs that qualify for deferral and the amortization period.

The commission accounting under the new standard is significantly different than the Company's current commission capitalization policy. The new standard will result in additional types of costs being capitalized. Additionally, all

amounts capitalized will be amortized over a period longer than the Company's current policy of amortizing the deferred amounts over the specific revenue contract terms. While the Company has not yet finalized its assessment of the impact the new commission accounting policy will have on its financial position and results of operations, the Company believes it will be material.

The Company does not expect the adoption of ASU 2014-09 to have any impact on its operating cash flows.



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In January 2016, the FASB issued Accounting Standards Update No. 2016-01, "Financial Instrument-Overall (Subtopic 825-10)" ("ASU 2016-01"), which requires entities to measure equity instruments at fair value and recognize any changes in fair value in net income. The guidance provides for electing the measurement alternative or defaulting to the fair value option. The Company plans to elect the measurement alternative for equity investments that do not have readily determinable fair values. These investments will be measured at cost, less any impairment, plus or minus adjustments resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer, which are recorded in net income. For those investments with readily determinable fair values, the Company will record the investments at fair value on a quarterly basis and record the change in net income. The new standard is effective for interim and annual periods beginning after December 15, 2017 and early adoption is permitted. The Company plans to adopt the new standard in its first quarter of fiscal 2019 and expects the adoption of ASU 2016-01 will impact its strategic investments portfolio. The Company is currently evaluating the impact to its consolidated financial statements and expects it could have a material impact, including additional volatility to other income (expense) within the Company's statements of operations, in future periods.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, "Leases (Topic 842)" ("ASU 2016-02"), which requires lessees to record most leases on their balance sheets but recognize the expenses on their statements of operations in a manner similar to current accounting rules. ASU 2016-02 states that a lessee would recognize a lease liability for the obligation to make lease payments and a right-to-use asset for the right to use the underlying asset for the lease term. The new standard is effective for interim and annual periods beginning after December 15, 2018 on a modified retrospective basis and early adoption is permitted. The Company expects its leases designated as operating leases in Note 13, "Commitments," will be reported on the consolidated balance sheets upon adoption. The Company is currently evaluating the impact to its consolidated financial statements as it relates to other aspects of the business. While the Company has not yet finalized its assessment, the Company currently plans to adopt the new standard in its first quarter of fiscal 2020.

In October 2016, the FASB issued Accounting Standards Update No. 2016-16, "Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory" ("ASU 2016-16"), which requires entities to recognize the income tax consequences of an intra-entity transfer of an asset, other than inventory, when the transfer occurs. The new standard is effective for annual periods beginning after December 15, 2017, with early adoption permitted as of the beginning of a fiscal year. The Company plans to adopt the new standard in its first quarter of fiscal 2019 and does not expect it to have a material impact on its consolidated financial statements.

**Reclassifications**

Certain reclassifications to fiscal 2017 balances were made to conform to the current period presentation in the consolidated balance sheets and consolidated statement of operations. These reclassifications include cost of revenues professional services and other, cost of revenues subscription and support, deferred revenue and deferred revenue, noncurrent.

**2. Investments****Marketable Securities**

At July 31, 2017, marketable securities consisted of the following (in thousands):

| Investments classified as Marketable Securities | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value  |
|---|----------------|------------------|-------------------|-------------|
| Corporate notes and obligations                 | \$952,187      | \$ 3,659         | \$ (593 )         | \$955,253   |
| U.S. treasury securities                        | 114,816        | 128              | (195 )            | 114,749     |
| Mortgage backed obligations                     | 107,789        | 141              | (354 )            | 107,576     |
| Asset backed securities                         | 206,874        | 202              | (108 )            | 206,968     |
| Municipal securities                            | 61,909         | 117              | (137 )            | 61,889      |
| Foreign government obligations                  | 56,562         | 94               | (25 )             | 56,631      |
| U.S. agency obligations                         | 2,995          | 5                | 0                 | 3,000       |
| Covered bonds                                   | 46,078         | 5                | (14 )             | 46,069      |
| Total marketable securities                     | \$1,549,210    | \$ 4,351         | \$ (1,426 )       | \$1,552,135 |



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At January 31, 2017, marketable securities consisted of the following (in thousands):

| Investments classified as Marketable Securities | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
|---|----------------|------------------|-------------------|------------|
| Corporate notes and obligations                 | \$ 321,284     | \$ 887           | \$ (1,531 )       | \$ 320,640 |
| U.S. treasury securities                        | 62,429         | 68               | (674 )            | 61,823     |
| Mortgage backed obligations                     | 74,882         | 39               | (669 )            | 74,252     |
| Asset backed securities                         | 101,913        | 74               | (197 )            | 101,790    |
| Municipal securities                            | 33,523         | 35               | (183 )            | 33,375     |
| Foreign government obligations                  | 10,491         | 3                | (36 )             | 10,458     |
| Total marketable securities                     | \$ 604,522     | \$ 1,106         | \$ (3,290 )       | \$ 602,338 |

The contractual maturities of the investments classified as marketable securities are as follows (in thousands):

|                                 | As of<br>July 31,<br>2017 | January 31,<br>2017 |
|---------------------------------|---------------------------|---------------------|
| Due within 1 year               | \$ 283,148                | \$ 104,631          |
| Due in 1 year through 5 years   | 1,261,051                 | 494,127             |
| Due in 5 years through 10 years | 7,936                     | 3,580               |
|                                 | \$ 1,552,135              | \$ 602,338          |

As of July 31, 2017, the following marketable securities were in an unrealized loss position (in thousands):

|                                 | Less than 12 Months |                   | 12 Months or Greater |                   | Total      |                   |
|---------------------------------|---------------------|-------------------|----------------------|-------------------|------------|-------------------|
|                                 | Fair Value          | Unrealized Losses | Fair Value           | Unrealized Losses | Fair Value | Unrealized Losses |
| Corporate notes and obligations | \$ 197,097          | \$ (593 )         | \$ 0                 | \$ 0              | \$ 197,097 | \$ (593 )         |
| U.S. treasury securities        | 75,471              | (195 )            | 0                    | 0                 | 75,471     | (195 )            |
| Mortgage backed obligations     | 71,945              | (324 )            | 2,520                | (30 )             | 74,465     | (354 )            |
| Asset backed securities         | 88,623              | (101 )            | 941                  | (7 )              | 89,564     | (108 )            |
| Municipal securities            | 33,555              | (137 )            | 0                    | 0                 | 33,555     | (137 )            |
| Foreign government obligations  | 8,878               | (25 )             | 0                    | 0                 | 8,878      | (25 )             |
| Covered bonds                   | 24,467              | (14 )             | 0                    | 0                 | 24,467     | (14 )             |
|                                 | \$ 500,036          | \$ (1,389 )       | \$ 3,461             | \$ (37 )          | \$ 503,497 | \$ (1,426 )       |

The unrealized losses for each of the fixed rate marketable securities were less than \$62,000. The Company does not believe any of the unrealized losses represent an other-than-temporary impairment based on its evaluation of available evidence as of July 31, 2017, such as the Company's intent to hold and whether it is more likely than not that the Company will be required to sell the investment before recovery of the investment's amortized basis. The Company expects to receive the full principal and interest on all of these marketable securities.

**Investment Income**

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

|                         | Three Months Ended July 31, 2017 |           | Six Months Ended July 31, 2017 |           |
|-------------------------|----------------------------------|-----------|--------------------------------|-----------|
|                         | 2017                             | 2016      | 2017                           | 2016      |
| Interest income         | \$ 8,748                         | \$ 6,546  | \$ 14,395                      | \$ 14,319 |
| Realized gains          | 353                              | 6,507     | 512                            | 7,561     |
| Realized losses         | (347 )                           | (1,137 )  | (887 )                         | (1,842 )  |
| Total investment income | \$ 8,754                         | \$ 11,916 | \$ 14,020                      | \$ 20,038 |

Reclassification adjustments out of accumulated other comprehensive income into net income were immaterial for the three and six months ended July 31, 2017 and 2016.



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## Strategic Investments

As of July 31, 2017, the Company had four investments in marketable equity securities with a fair value of \$119.1 million, which included an unrealized gain of \$64.7 million. As of January 31, 2017, the Company had six investments in marketable equity securities with a fair value of \$41.0 million, which included an unrealized gain of \$24.5 million. The change in the fair value of the investments in publicly held companies is recorded in the consolidated balance sheets within strategic investments and accumulated other comprehensive income.

As of July 31, 2017 and January 31, 2017, the carrying value of the Company's non-marketable debt and equity securities was \$538.5 million and \$526.0 million, respectively. The estimated fair value of the non-marketable debt and equity securities was approximately \$762.1 million and \$758.3 million as of July 31, 2017 and January 31, 2017, respectively.

## 3. Derivatives

Details on outstanding foreign currency derivative contracts are presented below (in thousands):

|  | As of            |                     |
|--|------------------|---------------------|
|  | July 31,<br>2017 | January 31,<br>2017 |
| Notional amount of foreign currency derivative contracts | \$1,268,065      | \$1,280,953         |
| Fair value of foreign currency derivative contracts      | \$(2,827 )       | \$10,205            |

The fair value of the Company's outstanding derivative instruments not designated as hedging instruments are summarized below (in thousands):

| Balance Sheet Location  | As of               |                        |
|---|---------------------|------------------------|
|   | July<br>31,<br>2017 | January<br>31,<br>2017 |
| Derivative Assets   |                     |                        |
| Foreign currency derivative contracts Prepaid expenses and other current assets | \$5,111             | \$13,238               |

## Derivative Liabilities

Foreign currency derivative contracts Accounts payable, accrued expenses and other liabilities \$7,938 \$3,033  
Gains/losses on derivative instruments not designated as hedging instruments recorded in Other income (expense) in the consolidated statements of operations during the three and six months ended July 31, 2017 and 2016, respectively, are summarized below (in thousands):

|                                       | Three Months<br>Ended<br>July 31, |            | Six Months Ended<br>July 31, |            |
|---------------------------------------|-----------------------------------|------------|------------------------------|------------|
|                                       | 2017                              | 2016       | 2017                         | 2016       |
| Foreign currency derivative contracts | \$3,420                           | \$(33,836) | \$10,279                     | \$(47,176) |

## 4. Fair Value Measurement

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

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

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

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

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



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The following table presents information about the Company's assets and liabilities that are measured at fair value as of July 31, 2017 and indicates the fair value hierarchy of the valuation (in thousands):

| Description                               | Quoted Prices in<br>Active Markets<br>for Identical Assets<br>(Level 1) | Significant Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Balances<br>as of<br>July 31,<br>2017 |
|---|---|--|--|---------------------------------------|
| Cash equivalents (1):                     |   |  |  |                                       |
| Time deposits                             | \$ 0  | \$ 457,739   | \$ 0   | \$457,739                             |
| Money market mutual funds                 | 773,617   | 0  | 0  | 773,617                               |
| Marketable securities:                    |   |  |  |                                       |
| Corporate notes and obligations           | 0   | 955,253  | 0  | 955,253                               |
| U.S. treasury securities                  | 0   | 114,749  | 0  | 114,749                               |
| Mortgage backed obligations               | 0   | 107,576  | 0  | 107,576                               |
| Asset backed securities                   | 0   | 206,968  | 0  | 206,968                               |
| Municipal securities                      | 0   | 61,889   | 0  | 61,889                                |
| Foreign government obligations            | 0   | 56,631   | 0  | 56,631                                |
| U.S. agency obligations                   | 0   | 3,000  | 0  | 3,000                                 |
| Covered bonds                             | 0   | 46,069   | 0  | 46,069                                |
| Foreign currency derivative contracts (2) | 0   | 5,111  | 0  | 5,111                                 |
| Total assets                              | \$ 773,617  | \$ 2,014,985   | \$ 0   | \$2,788,602                           |
| Liabilities:                              |   |  |  |                                       |
| Foreign currency derivative contracts (3) | 0   | 7,938  | 0  | 7,938                                 |
| Total liabilities                         | \$ 0  | \$ 7,938   | \$ 0   | \$7,938                               |

(1)Included in "cash and cash equivalents" in the accompanying consolidated balance sheet as of July 31, 2017, in addition to \$717.8 million of cash.

(2)Included in "prepaid expenses and other current assets" in the accompanying consolidated balance sheet as of July 31, 2017.

(3)Included in "accounts payable, accrued expenses and other liabilities" in the accompanying consolidated balance sheet as of July 31, 2017.

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The following table presents information about the Company's assets and liabilities that are measured at fair value as of January 31, 2017 and indicates the fair value hierarchy of the valuation (in thousands):

| Description                               | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balances as of January 31, 2017 |
|---|--|---|---|---------------------------------|
| Cash equivalents (1):                     |  |   |   |                                 |
| Time deposits                             | \$ 0   | \$ 25,100                                     | \$ 0                                      | \$ 25,100                       |
| Money market mutual funds                 | 956,479  | 0   | 0   | 956,479                         |
| Marketable securities:                    |  |   |   |                                 |
| Corporate notes and obligations           | 0  | 320,640                                       | 0   | 320,640                         |
| U.S. treasury securities                  | 0  | 61,823  | 0   | 61,823                          |
| Mortgage backed obligations               | 0  | 74,252  | 0   | 74,252                          |
| Asset backed securities                   | 0  | 101,790                                       | 0   | 101,790                         |
| Municipal securities                      | 0  | 33,375  | 0   | 33,375                          |
| Foreign government obligations            | 0  | 10,458  | 0   | 10,458                          |
| Foreign currency derivative contracts (2) | 0  | 13,238  | 0   | 13,238                          |
| Total assets                              | \$ 956,479   | \$ 640,676                                    | \$ 0                                      | \$ 1,597,155                    |
| Liabilities:                              |  |   |   |                                 |
| Foreign currency derivative contracts (3) | 0  | 3,033   | 0   | 3,033                           |
| Total liabilities                         | \$ 0   | \$ 3,033                                      | \$ 0                                      | \$ 3,033                        |

(1)Included in "cash and cash equivalents" in the accompanying consolidated balance sheet as of January 31, 2017, in addition to \$625.0 million of cash.

(2)Included in "prepaid expenses and other current assets" in the accompanying consolidated balance sheet as of January 31, 2017.

(3)Included in "accounts payable, accrued expenses and other liabilities" in the accompanying consolidated balance sheet as of January 31, 2017.

## 5. Property and Equipment

### Property and Equipment

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

|  | As of July 31, 2017 | January 31, 2017 |
|--|---------------------|------------------|
| Land   | \$ 183,888          | \$ 183,888       |
| Buildings and building improvements            | 623,411             | 621,377          |
| Computers, equipment and software              | 1,555,572           | 1,440,986        |
| Furniture and fixtures                         | 125,858             | 112,564          |
| Leasehold improvements                         | 741,466             | 627,069          |
|  | 3,230,195           | 2,985,884        |
| Less accumulated depreciation and amortization | (1,363,619 )        | (1,198,350 )     |
|  | \$ 1,866,576        | \$ 1,787,534     |

Depreciation and amortization expense totaled \$94.9 million and \$80.1 million during the three months ended July 31, 2017 and 2016, respectively, and \$183.0 million and \$155.7 million during the six months ended July 31, 2017 and 2016, respectively.

Computers, equipment and software at July 31, 2017 and January 31, 2017 included a total of \$729.6 million and \$729.0 million acquired under capital lease agreements, respectively. Accumulated amortization relating to computers, equipment and software acquired under capital leases totaled \$430.4 million and \$386.9 million, respectively, at July 31, 2017 and January 31, 2017. Amortization of assets acquired under capital leases is included in



depreciation and amortization expense.

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## Building - 350 Mission

In December 2013, the Company entered into a lease agreement for approximately 445,000 rentable square feet of office space at 350 Mission Street (“350 Mission”) in San Francisco, California, which is the total office space available in the building. As a result of the Company’s involvement during the construction period, the Company is considered for accounting purposes to be the owner of 350 Mission. As a result, the Company has capitalized the construction costs as Building with a corresponding current and noncurrent financing obligation liability and has accounted for the underlying land implicitly as an operating lease. As of July 31, 2017, the Company had capitalized \$178.8 million of construction costs, based on the construction costs incurred to date by the landlord, and recorded a corresponding current and noncurrent financing obligation liability of \$19.8 million and \$199.5 million, respectively. As of January 31, 2017, the Company had capitalized \$178.8 million of construction costs, based on the construction costs incurred to date by the landlord, and recorded a corresponding current and noncurrent financing obligation liability of \$19.6 million and \$200.7 million, respectively. The total expected financing obligation in the form of minimum lease payments inclusive of the amounts currently recorded is \$311.7 million, including interest (see Note 13 “Commitments” for future commitment details). The obligation will be settled through monthly lease payments to the landlord, which commenced in October 2015. To the extent that operating expenses for 350 Mission are material, the Company, as the deemed accounting owner, will record the operating expenses.

## 6. Business Combinations

In February 2017, the Company acquired Sequence, Inc. for an aggregate of \$26.0 million in cash and equity, net of cash acquired, and has included the financial results of the company in its consolidated financial statements from the date of acquisition. The costs associated with this acquisition were not material. The Company accounted for this acquisition as a business combination. In allocating the purchase consideration based on estimated fair values, the Company recorded \$2.7 million of intangible assets and \$23.0 million of goodwill. The goodwill balance associated with this business combination is deductible for U.S. income tax purposes. The Company expects to finalize the valuation as soon as practicable, but not later than one year from the acquisition date.

The Company finalized its purchase accounting for several acquisitions in the three months ended July 31, 2017 resulting in adjustments to goodwill, intangible assets and other balance sheet accounts.

## 7. Intangible Assets Acquired Through Business Combinations and Goodwill

Intangible assets acquired through business combinations

Intangible assets acquired through business combinations are as follows (in thousands):

|                               | Intangible Assets, Gross |           |               | Accumulated Amortization |             |               | Intangible Assets, Net |               |     | Weighted Average Useful Life |
|-------------------------------|--------------------------|-----------|---------------|--------------------------|-------------|---------------|------------------------|---------------|-----|------------------------------|
|                               | Jan 31, 2017             | Additions | July 31, 2017 | Jan 31, 2017             | Expense     | July 31, 2017 | Jan 31, 2017           | July 31, 2017 |     |                              |
| Acquired developed technology | \$1,092,161              | \$0       | \$1,092,161   | \$(577,929)              | \$(86,362)  | \$(664,291)   | \$514,232              | \$427,870     | 3.2 |                              |
| Customer relationships        | 843,614                  | 1,690     | 845,304       | (254,035)                | (60,204)    | (314,239)     | 589,579                | 531,065       | 4.9 |                              |
| Trade names and trademarks    | 45,950                   | 0         | 45,950        | (41,349)                 | (1,020)     | (42,369)      | 4,601                  | 3,581         | 1.8 |                              |
| Territory rights and other    | 15,786                   | 0         | 15,786        | (12,256)                 | (840)       | (13,096)      | 3,530                  | 2,690         | 8.5 |                              |
| 50 Fremont lease intangibles  | 7,713                    | 0         | 7,713         | (6,281)                  | (751)       | (7,032)       | 1,432                  | 681           | 2.9 |                              |
| Total                         | \$2,005,224              | \$1,690   | \$2,006,914   | \$(891,850)              | \$(149,177) | \$(1,041,027) | \$1,113,374            | \$965,887     | 4.1 |                              |

Amortization of intangible assets and unfavorable lease liabilities, which are not reflected in the table above, resulting from business combinations for the three months ended July 31, 2017 and 2016 was \$74.4 million and \$49.3 million,

respectively, and for the six months ended July 31, 2017 and 2016 was \$149.0 million and \$87.6 million, respectively.

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The expected future amortization expense for intangible assets as of July 31, 2017 is as follows (in thousands):

Fiscal Period:

|                                     |            |
|-------------------------------------|------------|
| Remaining six months of Fiscal 2018 | \$ 139,173 |
| Fiscal 2019                         | 266,233    |
| Fiscal 2020                         | 225,039    |
| Fiscal 2021                         | 169,481    |
| Fiscal 2022                         | 111,353    |
| Thereafter                          | 54,608     |
| Total amortization expense          | \$965,887  |

Goodwill

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

The changes in the carrying amounts of goodwill, which is generally not deductible for tax purposes, were as follows (in thousands):

|   |             |
|---|-------------|
| Balance as of January 31, 2017  | \$7,263,846 |
| Sequence, Inc. acquisition  | 22,982      |
| Adjustments of acquisition date fair values, including the effect of foreign currency translation | 7,553       |
| Balance as of July 31, 2017   | \$7,294,381 |

## 8. Debt

### Convertible Senior Notes

| (in thousands)                                   | Par Value Outstanding | Equity Component Recorded at Issuance | Liability Component of Par Value as of July 31, 2017 | January 31, 2017 |
|--|-----------------------|---------------------------------------|--|------------------|
| 0.25% Convertible Senior Notes due April 1, 2018 | \$ 1,150,000          | \$ 122,421                            | (1)\$ 1,130,729                                      | \$ 1,116,360     |

(1) This amount represents the equity component recorded at the initial issuance of the 0.25% convertible senior notes. As of July 31, 2017, \$17.2 million was reclassified to temporary equity on the accompanying consolidated balance sheet as these notes are convertible for the three months ending October 31, 2017 based on the conversion criteria below.

In March 2013, the Company issued at par value \$1.15 billion of 0.25% convertible senior notes (the "0.25% Senior Notes", or "Notes") due April 1, 2018, unless earlier purchased by the Company or converted and are therefore classified as current on the consolidated balance sheet as of July 31, 2017 as they are due within one year. Interest is payable semi-annually, in arrears on April 1 and October 1 of each year.

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

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

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

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



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

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

during any fiscal quarter, if, for at least 20 trading days during the 30 consecutive trading day period ending on the last trading day of the immediately preceding fiscal quarter, the last reported sales price of the Company's common stock for such trading day is greater than or equal to 130% of the applicable conversion price on such trading day; in certain situations, when the trading price of the 0.25% Senior Notes is less than 98% of the product of the sale price of the Company's common stock and the conversion rate;

upon the occurrence of specified corporate transactions described under the 0.25% Senior Notes indenture, such as a consolidation, merger or binding share exchange; or

at any time on or after the convertible date noted above (as described in the indenture).

Holders of the 0.25% Senior Notes have the right to require the Company to purchase with cash all or a portion of the Notes upon the occurrence of a fundamental change, such as a change of control, at a purchase price equal to 100% of the principal amount of the 0.25% Senior Notes plus accrued and unpaid interest. Following certain corporate transactions that constitute a change of control, the Company will increase the conversion rate for a holder who elects to convert the 0.25% Senior Notes in connection with such change of control.

In accounting for the issuances of the 0.25% Senior Notes, the Company separated the 0.25% Senior Notes into liability and equity components. The carrying amount of the liability component was calculated by measuring the fair value of a similar liability that does not have an associated convertible feature. The carrying amount of the equity component representing the conversion option was determined by deducting the fair value of the liability component from the par value of the 0.25% Senior Notes as a whole. The excess of the principal amount of the liability component over its carrying amount ("debt discount") is amortized to interest expense over the term of the 0.25% Senior Notes. The equity component is not remeasured as long as it continues to meet the conditions for equity classification. In any period when holders of the 0.25% Senior Notes are eligible to exercise their conversion option, the equity component related to convertible debt instruments is required to be reclassified from permanent equity to temporary equity. Therefore, if in any future period the holders of the 0.25% Senior Notes are able to exercise their conversion rights, then the difference between (1) the amount of cash deliverable upon conversion (i.e., par value of debt) and (2) the carrying value of the debt component will be reclassified from permanent equity to temporary equity, and will continue to be reported as temporary equity for any period in which the debt remains currently convertible.

In accounting for the transaction costs related to the 0.25% Senior Notes issuance, the Company allocated the total amount incurred to the liability and equity components based on their relative values. Transaction costs attributable to the liability component are being amortized to expense over the terms of the 0.25% Senior Notes, and transaction costs attributable to the equity component were netted with the equity component in stockholders' equity.

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

|                              | As of       |             |
|------------------------------|-------------|-------------|
|                              | July 31,    | January 31, |
|                              | 2017        | 2017        |
| Liability component:         |             |             |
| Principal (1)                | \$1,150,000 | \$1,150,000 |
| Less: debt discount, net (2) | (17,223 )   | (29,954 )   |
| Less: debt issuance cost     | (2,048 )    | (3,686 )    |
| Net carrying amount          | \$1,130,729 | \$1,116,360 |

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

(2)Included in the consolidated balance sheets within Convertible 0.25% Senior Notes (which is classified as a current liability as of July 31, 2017 and a noncurrent liability as of January 31, 2017) and is amortized over the life of the 0.25% Senior Notes using the effective interest rate method.



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The total estimated fair value of the Company's 0.25% Senior Notes at July 31, 2017 was \$1.6 billion. The fair value was determined based on the closing trading price per \$100 of the 0.25% Senior Notes as of the last day of trading for the second quarter of fiscal 2018.

Based on the closing price of the Company's common stock of \$90.80 on July 31, 2017, the if-converted value of the 0.25% Senior Notes exceeded their principal amount by approximately \$421.6 million.

**Note Hedges**

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

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

The 0.25% Note Hedges cover shares of the Company's common stock at a strike price that corresponds to the initial conversion price of the 0.25% Senior Notes, also subject to adjustment, and are exercisable upon conversion of the Notes. The 0.25% Note Hedges will expire upon the maturity of the 0.25% Senior Notes. The 0.25% Note Hedges are intended to reduce the potential economic dilution upon conversion of the 0.25% Senior Notes in the event that the market value per share of the Company's common stock, as measured under the 0.25% Senior Notes, at the time of exercise is greater than the conversion price of the 0.25% Senior Notes. The 0.25% Note Hedges are separate transactions and are not part of the terms of the 0.25% Senior Notes. Holders of the 0.25% Senior Notes will not have any rights with respect to the 0.25% Note Hedges. The 0.25% Note Hedges do not impact earnings per share.

**Warrants**

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

In March 2013, the Company also entered into a warrants transaction ("0.25% Warrants"), whereby the Company sold warrants to acquire, subject to anti-dilution adjustments, shares of the Company's common stock. If the 0.25% Warrants are not exercised on their exercise dates, which are in fiscal 2019, they will expire. If the market value per share of the Company's common stock exceeds the applicable exercise price of the 0.25% Warrants, the 0.25% Warrants will have a dilutive effect on the Company's earnings per share if the Company has achieved profitability at that time. The 0.25% Warrants were anti-dilutive for the periods presented. The 0.25% Warrants are separate transactions entered into by the Company and are not part of the terms of the 0.25% Senior Notes or the 0.25% Note Hedges. Holders of the 0.25% Senior Notes and 0.25% Note Hedges will not have any rights with respect to the 0.25% Warrants.

**Term Loan**

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

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

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

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

The Term Loan Credit Agreement contains customary affirmative and negative covenants, including covenants that limit or restrict the Company and its subsidiaries' ability to, among other things, incur indebtedness, grant liens, merge or consolidate, dispose of assets, make investments, make acquisitions, enter into transactions with affiliates, pay



dividends or make distributions and repurchase stock. The Company is also required to maintain compliance with a consolidated leverage

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ratio and a consolidated interest coverage ratio. The Term Loan Credit Agreement includes customary events of default. Under certain circumstances, a default interest rate will apply on all obligations during the existence of an event of default under the Term Loan Credit Agreement at a per annum rate equal to 2.00% above the applicable interest rate for any overdue principal and 2.00% above the rate applicable for base rate loans for any other overdue amounts. The occurrence of an event of default could result in the acceleration of obligations under the Term Loan Credit Agreement. The Company was in compliance with the Term Loan Credit Agreement's covenants as of July 31, 2017.

The weighted average interest rate on the Term Loan was 2.1% for the three months ended July 31, 2017. Accrued interest on the Term Loan was \$0.4 million as of July 31, 2017. As of July 31, 2017, the noncurrent outstanding principal portion was \$500.0 million.

**Revolving Credit Facility**

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

The borrowings under the Credit Facility bear interest, at the Company's option, at a base rate plus a spread of 0.00% to 0.75% or an adjusted LIBOR rate plus a spread of 1.00% to 1.75%, in each case with such spread being determined based on the Company's consolidated leverage ratio for the preceding four fiscal quarter period. Interest is due and payable in arrears quarterly for loans bearing interest at a rate based on the base rate and at the end of an interest period in the case of loans bearing interest at the adjusted LIBOR rate. Regardless of what amounts, if any, are outstanding under the Credit Facility, the Company is also obligated to pay an ongoing commitment fee on undrawn amounts at a rate of 0.125% to 0.25%, with such rate being based on the Company's consolidated leverage ratio for the preceding four fiscal quarter period, payable in arrears quarterly.

The Revolving Loan Credit Agreement contains customary affirmative and negative covenants, including covenants that limit or restrict the Company and its subsidiaries' ability to, among other things, incur indebtedness, grant liens, merge or consolidate, dispose of assets, make investments, make acquisitions, enter into transactions with affiliates, pay dividends or make distributions and repurchase stock. The Company is also required to maintain compliance with a consolidated leverage ratio and a consolidated interest coverage ratio. The Revolving Loan Credit Agreement includes customary events of default. Under certain circumstances, a default interest rate will apply on all obligations during the existence of an event of default under the Revolving Loan Credit Agreement at a per annum rate equal to 2.00% above the applicable interest rate for any overdue principal and 2.00% above the rate applicable for base rate loans for any other overdue amounts. The occurrence of an event of default could result in the acceleration of obligations under the Revolving Loan Credit Agreement. The Company was in compliance with the Revolving Loan Credit Agreement's covenants as of July 31, 2017.

In February 2017, the Company paid down the remaining \$200.0 million of outstanding borrowings under the Credit Facility. There were no outstanding borrowings under the Credit Facility as of July 31, 2017. The Company continues to pay a commitment fee on the available amount of the Credit Facility.

**Loan Assumed on 50 Fremont**

The Company assumed a \$200.0 million loan with the acquisition of 50 Fremont ("Loan"). The Loan bears an interest rate of 3.75% per annum and is due in June 2023. For the remainder of fiscal 2018, the Loan requires interest only payments. Beginning in fiscal 2019, principal and interest payments are required, with the remaining principal due at maturity. For the three months ended July 31, 2017 and 2016, total interest expense recognized was \$1.9 million and \$1.9 million, respectively. For the six months ended July 31, 2017 and 2016, total interest expense recognized was \$3.8 million and \$3.8 million, respectively. The Loan can be prepaid at any time subject to a yield maintenance fee. The agreement governing the Loan contains certain customary affirmative and negative covenants that the Company was in compliance with as of July 31, 2017.



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

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

|                                     | Three Months        |          | Six Months          |          |
|-------------------------------------|---------------------|----------|---------------------|----------|
|                                     | Ended July 31, 2017 | 2016     | Ended July 31, 2017 | 2016     |
| Contractual interest expense        | \$5,596             | \$3,377  | \$11,278            | \$6,191  |
| Amortization of debt issuance costs | 1,332               | 1,701    | 2,664               | 2,729    |
| Amortization of debt discount       | 6,423               | 6,264    | 12,806              | 12,490   |
|                                     | \$13,351            | \$11,342 | \$26,748            | \$21,410 |

## 9. Other Balance Sheet Accounts

## Prepaid Expenses and Other Current Assets

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

|   | As of         |                  |
|---|---------------|------------------|
|   | July 31, 2017 | January 31, 2017 |
| Prepaid income taxes                      | \$75,031      | \$26,932         |
| Other taxes receivable                    | 36,634        | 34,177           |
| Prepaid expenses and other current assets | 326,581       | 218,418          |
|   | \$438,246     | \$279,527        |

## Capitalized Software, net

Capitalized software, net at July 31, 2017 and January 31, 2017 was \$140.7 million and \$141.7 million, respectively. Accumulated amortization relating to capitalized software, net totaled \$287.9 million and \$250.9 million, respectively, at July 31, 2017 and January 31, 2017.

Capitalized internal-use software amortization expense totaled \$19.0 million and \$15.9 million for the three months ended July 31, 2017 and 2016, respectively and \$37.0 million and \$30.9 million for the six months ended July 31, 2017 and 2016, respectively.

The Company capitalized \$2.0 million and \$1.6 million of stock-based expenses related to capitalized internal-use software development during the three months ended July 31, 2017 and 2016, respectively, and \$3.9 million and \$3.4 million for the six months ended July 31, 2017 and 2016, respectively.

## Other Assets, net

Other assets consisted of the following (in thousands):

|  | As of         |                  |
|--|---------------|------------------|
|  | July 31, 2017 | January 31, 2017 |
| Deferred income taxes, noncurrent, net | \$29,926      | \$28,939         |
| Long-term deposits                     | 24,305        | 23,597           |
| Domain names and patents, net          | 30,662        | 39,213           |
| Customer contract asset (1)            | 229,597       | 281,733          |
| Other                                  | 143,506       | 113,387          |
|  | \$457,996     | \$486,869        |

(1) Customer contract asset reflects the fair value of future billings of amounts that are contractually committed by acquired companies' existing customers as of the acquisition date.

Domain names and patents amortization expense was \$4.3 million and \$4.6 million for the three months ended July 31, 2017 and 2016, respectively, and \$8.7 million and \$7.8 million for the six months ended July 31, 2017 and 2016, respectively.



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## Accounts Payable, Accrued Expenses and Other Liabilities

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

|   | As of            |                     |
|---|------------------|---------------------|
|   | July 31,<br>2017 | January 31,<br>2017 |
| Accounts payable                                | \$148,279        | \$115,257           |
| Accrued compensation                            | 517,433          | 730,390             |
| Non-cash equity liability (1)                   | 55,394           | 68,355              |
| Accrued other liabilities                       | 452,398          | 419,299             |
| Accrued income and other taxes payable          | 196,670          | 239,699             |
| Accrued professional costs                      | 46,579           | 38,254              |
| Accrued rent                                    | 21,384           | 19,710              |
| Capital lease obligation, current               | 118,888          | 102,106             |
| Financing obligation - leased facility, current | 19,797           | 19,594              |
|   | \$1,576,822      | \$1,752,664         |

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

## Other Noncurrent Liabilities

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

|  | As of            |                     |
|--|------------------|---------------------|
|  | July 31,<br>2017 | January 31,<br>2017 |
| Deferred income taxes and income taxes payable | \$111,404        | \$99,378            |
| Financing obligation - leased facility         | 199,539          | 200,711             |
| Long-term lease liabilities and other          | 416,939          | 480,850             |
|  | \$727,882        | \$780,939           |

## 10. Stockholders' Equity

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

As of July 31, 2017, \$52.8 million has been withheld on behalf of employees for future purchases under the ESPP and is recorded in accounts payable, accrued expenses and other liabilities.

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

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

|                         | Three Months Ended |           | Six Months Ended |               |
|-------------------------|--------------------|-----------|------------------|---------------|
|                         | July 31,           |           | July 31,         |               |
|                         | 2017               | 2016      | 2017             | 2016          |
| Stock Options           |                    |           |                  |               |
| Volatility              | 30.8 %             | 32.3 %    | 30.8 - 31.4 %    | 32.1 - 32.3 % |
| Estimated life          | 3.5 years          | 3.5 years | 3.5 years        | 3.5 years     |
| Risk-free interest rate | 1.6 %              | %         | %                | %             |

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|   | 0.9 -   | 1.4 -   | 0.9 -   |         |
|---|---------|---------|---------|---------|
|   | 1.1     | 1.6     | 1.1     |         |
| Weighted-average fair value per share of grants | \$22.20 | \$20.22 | \$21.08 | \$18.76 |

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|   | Three Months<br>Ended<br>July 31, |                |   |  |
|---|-----------------------------------|----------------|---|--|
|   | 2017                              | 2016           |   |  |
| ESPP  |                                   |                |   |  |
| Volatility                                      | 26.8 -<br>27.6                    | % 34.0         | % |  |
| Estimated life                                  | 0.75<br>years                     | 0.75<br>years  |   |  |
| Risk-free interest rate                         | 1.1 -<br>1.2                      | % 0.5 -<br>0.6 | % |  |
| Weighted-average fair value per share of grants | \$21.13                           | \$21.93        |   |  |

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

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

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

The estimated forfeiture rate applied is based on historical forfeiture rates. The Company does not anticipate paying any cash dividends in the foreseeable future and therefore uses an expected dividend yield of zero in the option pricing model.

During fiscal 2016, the Company granted a performance-based restricted stock unit award to the Chairman of the Board and Chief Executive Officer and during fiscal 2017, the Company granted performance-based restricted stock unit awards to certain executive officers, including the Chairman of the Board and Chief Executive Officer. The performance-based restricted stock unit awards are subject to vesting based on a performance-based condition and a service-based condition. At the end of the three-year service period, based on the Company's share price performance, these performance-based restricted stock units will vest in a percentage of the target number of shares between 0 and 200%, depending on the extent the performance condition is achieved.

Stock activity excluding the ESPP is as follows:

|  | Shares<br>Available<br>for<br>Grant | Options Outstanding | Weighted-<br>Average<br>Exercise Price | Aggregate<br>Intrinsic<br>Value (in<br>thousands) |
|--|-------------------------------------|---------------------|--|---|
| Balance as of January 31, 2017                   | 16,531,822                          | 30,353,076          | \$ 59.88                               |   |
| Increase in shares authorized:                   |                                     |                     |  |   |
| 2013 Equity Incentive Plan                       | 37,009,109                          | 0                   | 0.00                                   |   |
| 2014 Inducement Plan                             | 15,233                              | 0                   | 0.00                                   |   |
| Options granted under all plans                  | (624,256 )                          | 624,256             | 84.36                                  |   |
| Restricted stock activity                        | (1,783,395 )                        | 0                   | 0.00                                   |   |
| Stock grants to board and advisory board members | (114,550 )                          | 0                   | 0.00                                   |   |
| Exercised  | 0                                   | (5,241,224 )        | 41.31                                  |   |
| Plan shares expired                              | (32,469 )                           | 0                   | 0.00                                   |   |
| Canceled   | 686,925                             | (686,925 )          | 71.54                                  |   |
| Balance as of July 31, 2017                      | 51,688,419                          | 25,049,183          | \$ 64.06                               | \$ 669,906  |
| Vested or expected to vest                       |                                     | 23,264,036          | \$ 63.45                               | \$ 636,380  |



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|                                 |            |          |            |
|---------------------------------|------------|----------|------------|
| Exercisable as of July 31, 2017 | 10,102,024 | \$ 56.48 | \$ 346,679 |
|---------------------------------|------------|----------|------------|

The total intrinsic value of the options exercised during the six months ended July 31, 2017 and 2016 was \$234.6 million and \$124.8 million, respectively. The intrinsic value is the difference between the current market value of the stock and the exercise price of the stock option.

The weighted-average remaining contractual life of vested and expected to vest options is approximately 5 years.

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As of July 31, 2017, options to purchase 10,102,024 shares were vested at a weighted average exercise price of \$56.48 per share and had a remaining weighted-average contractual life of approximately 4.3 years. The total intrinsic value of these vested options as of July 31, 2017 was \$346.7 million.

During the six months ended July 31, 2017, the Company recognized stock-based expense related to its equity plans for employees and non-employee directors of \$508.1 million. As of July 31, 2017, the aggregate stock compensation remaining to be amortized to costs and expenses was approximately \$2.2 billion. The Company will amortize this stock compensation balance as follows: \$487.8 million during the remaining six months of fiscal 2018; \$770.7 million during fiscal 2019; \$561.3 million during fiscal 2020; \$283.8 million during fiscal 2021; \$27.1 million during fiscal 2022 and \$25.2 million thereafter. The expected amortization reflects only outstanding stock awards as of July 31, 2017 and assumes no forfeiture activity.

The aggregate stock compensation remaining to be amortized to costs and expenses will be recognized over a weighted average period of 1.9 years.

The following table summarizes information about stock options outstanding as of July 31, 2017:

| Range of Exercise Prices | Options Outstanding |   |                                 | Options Exercisable |                                 |
|--------------------------|---------------------|---|---------------------------------|---------------------|---------------------------------|
|                          | Number Outstanding  | Weighted-Average Remaining Contractual Life (Years) | Weighted-Average Exercise Price | Number of Shares    | Weighted-Average Exercise Price |
| \$0.86 to \$52.30        | 5,359,081           | 4.5   | \$ 35.63                        | 4,089,957           | \$ 40.90                        |
| \$53.60 to \$58.86       | 795,195             | 4.0   | 55.57                           | 457,494             | 55.62                           |
| \$59.34                  | 5,102,948           | 4.3   | 59.34                           | 3,109,676           | 59.34                           |
| \$59.37 to \$75.01       | 1,691,499           | 5.4   | 69.42                           | 389,487             | 69.47                           |
| \$75.57                  | 5,834,266           | 6.3   | 75.57                           | 0                   | 0.00                            |
| \$76.48 to \$80.62       | 590,034             | 5.9   | 78.52                           | 114,718             | 78.96                           |
| \$80.99 to \$89.69       | 5,676,160           | 5.5   | 81.39                           | 1,940,692           | 81.01                           |
|                          | 25,049,183          | 5.2   | \$ 64.06                        | 10,102,024          | \$ 56.48                        |

Restricted stock activity is as follows:

|   | Restricted Stock Outstanding |                                 |  |
|---|------------------------------|---------------------------------|--|
|   | Outstanding                  | Weighted-Average Exercise Price | Aggregate Intrinsic Value (in thousands) |
| Balance as of January 31, 2017              | 27,453,498                   | \$ 0.001                        |  |
| Granted - restricted stock units and awards | 1,886,779                    | 0.001                           |  |
| Canceled                                    | (1,100,273 )                 | 0.001                           |  |
| Vested and converted to shares              | (3,930,974 )                 | 0.001                           |  |
| Balance as of July 31, 2017                 | 24,309,030                   | \$ 0.001                        | \$2,207,260                              |
| Expected to vest                            | 21,017,129                   |                                 | \$1,908,355                              |

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

The weighted-average grant date fair value of the restricted stock issued for the six months ended July 31, 2017 and 2016 was \$85.96 and \$75.86, respectively.

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## Common Stock

The following number of shares of common stock were reserved and available for future issuance at July 31, 2017:

|   |             |
|---|-------------|
| Options outstanding   | 25,049,183  |
| Restricted stock awards and units and performance stock units outstanding | 24,309,030  |
| Stock available for future grant:   |             |
| 2013 Equity Incentive Plan  | 51,117,833  |
| 2014 Inducement Plan  | 488,180     |
| Amended and Restated 2004 Employee Stock Purchase Plan                    | 8,629,807   |
| Acquired equity plans   | 82,406      |
| Convertible Senior Notes  | 17,308,880  |
| Warrants  | 17,308,880  |
|   | 144,294,199 |

## 11. Income Taxes

## Effective Tax Rate

The Company computes its year-to-date provision for income taxes by applying the estimated annual effective tax rate to year to date pretax income or loss and adjusts the provision for discrete tax items recorded in the period. For the six months ended July 31, 2017, the Company reported a tax benefit of \$1.0 million on a pretax income of \$7.5 million, which resulted in an effective tax rate of negative 14 percent. The Company recorded year-to-date tax provision primarily from profitable jurisdictions outside of the United States; however, due to various discrete tax benefits, including excess tax benefits from stock options and vesting of restricted stocks, the result was a small net tax benefit. The Company regularly assesses the realizability of the deferred tax assets and establishes a valuation allowance if it is more-likely-than-not that some or all of the Company's deferred tax assets will not be realized. The Company evaluates and weighs all available positive and negative evidence such as historic results, future reversals of existing deferred tax liabilities, projected future taxable income, as well as prudent and feasible tax-planning strategies. Generally, more weight is given to objectively verifiable evidence. The Company will continue to assess the realizability of the deferred tax assets in each of the applicable jurisdictions going forward. The Company will adjust its valuation allowance in the event sufficient positive evidence overcomes the negative evidence of losses in recent years, for example, if the trend in increasing annual taxable income continues.

For the six months ended July 31, 2016, the Company reported a tax benefit of \$206.9 million on a pretax income of \$61.4 million, which resulted in a negative effective tax rate of 337 percent. The most significant component of this tax amount was the discrete tax benefit of \$265.7 million from a partial release of the valuation allowance in connection with the acquisition of Demandware. The net deferred tax liability from the acquisition of Demandware provided a source of additional income to support the realizability of the Company's pre-existing deferred tax assets and as a result, the Company released a portion of its valuation allowance. The tax benefit associated with the release of the valuation allowance was partially offset by income taxes in profitable jurisdictions outside of the United States.

## Tax Benefits Related to Stock-Based Compensation

The income tax benefit related to stock-based compensation was \$138.6 million and \$103.8 million for the six months ended July 31, 2017 and 2016, respectively, the majority of which was not recognized as a result of the valuation allowance.

## Unrecognized Tax Benefits and Other Considerations

The Company records liabilities related to its uncertain tax positions. Tax positions for the Company and its subsidiaries are subject to income tax audits by multiple tax jurisdictions throughout the world. Certain prior year tax returns are currently being examined by various taxing authorities in countries including the United States, France, United Kingdom and Germany. In March 2017, the Company received the final notice of proposed adjustments primarily related to transfer pricing issues from the Internal Revenue Service ("IRS") for fiscal 2011 and fiscal 2012. Accordingly, the Company re-assessed and adjusted its reserves, which resulted in a net immaterial impact to the tax provision due to its valuation allowance. The Company is currently appealing the IRS proposed adjustments. The Company believes that it has provided adequate reserves for its income tax uncertainties in all open tax years. As the outcome of the tax audits cannot be predicted with certainty, if any issues addressed in the Company's tax audits are

resolved in a manner inconsistent with management's expectations, the Company could adjust its provision for income taxes in the future. Generally, any adjustments resulting from the U.S. audits should not

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have a significant impact to the Company's tax provision due to its valuation allowance. In addition, the Company anticipates it is reasonably possible that a decrease of unrecognized tax benefits up to approximately \$9.0 million may occur in the next 12 months, as the applicable statutes of limitations lapse.

## 12. Earnings Per Share

Basic earnings per share is computed by dividing net income by the weighted-average number of common shares outstanding for the fiscal period. Diluted earnings per share is computed by giving effect to all potential weighted average dilutive common stock, including options, restricted stock units, warrants and the convertible senior notes. The dilutive effect of outstanding awards and convertible securities is reflected in diluted earnings per share by application of the treasury stock method.

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

|   | Three Months<br>Ended July 31, |            | Six Months<br>Ended July 31, |            |
|---|--------------------------------|------------|------------------------------|------------|
|   | 2017                           | 2016       | 2017                         | 2016       |
| Numerator:  |                                |            |                              |            |
| Net income  | \$ 17,736                      | \$ 229,622 | \$ 8,529                     | \$ 268,381 |
| Denominator:  |                                |            |                              |            |
| Weighted-average shares outstanding for basic earnings per share                                    | 712,039                        | 681,126    | 709,157                      | 678,929    |
| Effect of dilutive securities:  |                                |            |                              |            |
| Convertible senior notes  | 4,336                          | 2,977      | 3,863                        | 1,961      |
| Employee stock awards   | 13,011                         | 11,865     | 13,202                       | 10,824     |
| Adjusted weighted-average shares outstanding and assumed conversions for diluted earnings per share | 729,386                        | 695,968    | 726,222                      | 691,714    |

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

|                       | Three Months<br>Ended July 31, |        | Six Months<br>Ended July 31, |        |
|-----------------------|--------------------------------|--------|------------------------------|--------|
|                       | 2017                           | 2016   | 2017                         | 2016   |
| Employee stock awards | 12,691                         | 7,414  | 13,256                       | 8,263  |
| Warrants              | 17,309                         | 17,309 | 17,309                       | 17,309 |

## 13. Commitments

## Letters of Credit

As of July 31, 2017, the Company had a total of \$86.6 million in letters of credit outstanding substantially in favor of certain landlords for office space. These letters of credit renew annually and expire at various dates through December 2030.

## Leases

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

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As of July 31, 2017, the future minimum lease payments under non-cancelable operating and capital leases are as follows (in thousands):

|  | Capital<br>Leases | Operating<br>Leases | Financing<br>Obligation<br>-Leased<br>Facility (1) |
|--|-------------------|---------------------|--|
| Fiscal Period:                             |                   |                     |  |
| Remaining six months of Fiscal 2018        | \$29,450          | \$273,221           | \$ 10,792  |
| Fiscal 2019                                | 115,834           | 505,431             | 21,881   |
| Fiscal 2020                                | 201,618           | 433,161             | 22,325   |
| Fiscal 2021                                | 75                | 320,162             | 22,770   |
| Fiscal 2022                                | 37                | 276,137             | 23,214   |
| Thereafter                                 | 3                 | 1,402,990           | 210,713  |
| Total minimum lease payments               | 347,017           | \$3,211,102         | \$ 311,695   |
| Less: amount representing interest         | (23,554 )         |                     |  |
| Present value of capital lease obligations | \$323,463         |                     |  |

(1) Total Financing Obligation - Leased Facility noted above represents the total obligation on the lease agreement including amounts allocated to interest noted in Note 5 "Property and Equipment." As of July 31, 2017, \$219.3 million of the total \$311.7 million above was recorded to Financing obligation leased facility, of which the current portion is included in "Accounts payable, accrued expenses and other liabilities" and the noncurrent portion is included in "Other noncurrent liabilities" on the consolidated balance sheets.

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

The terms of the lease agreements provide for rental payments on a graduated basis. The Company recognizes rent expense on a straight-line basis over the lease period and has accrued for rent expense incurred but not paid. Of the total operating lease commitment balance of \$3.2 billion, approximately \$2.7 billion is related to facilities space. The remaining commitment amount is related to computer equipment and furniture and fixtures.

#### Other Purchase Commitments

In April 2016, the Company entered into an agreement with a third-party provider for certain infrastructure services for a period of four years. The Company paid \$96.0 million in connection with this agreement during the six months ended July 31, 2017. The agreement further provides that the Company will pay an additional \$108.0 million in fiscal 2019 and \$126.0 million in fiscal 2020.

#### 14. Legal Proceedings and Claims

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

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

The Company makes a provision for a liability relating to legal matters when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, estimated settlements, legal rulings, advice of legal counsel and other information and events pertaining to a particular matter. The outcomes of legal proceedings and other contingencies are, however, inherently unpredictable and subject to significant uncertainties. As a result, the Company is not able to reasonably estimate the amount or range of possible losses in excess of any amounts accrued, including losses that could arise as a result of application of non-monetary remedies, with respect to the contingencies it faces,

and the Company's estimates may not prove to be accurate. In management's opinion, resolution of all current matters is not expected to have a material adverse impact on the Company's consolidated results of operations, cash flows or financial position. However, depending on the nature and timing of any such dispute, an unfavorable resolution of a matter could materially affect the Company's current or future results of operations or cash flows, or both, in a particular quarter.

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In September 2013, one of the Company's subsidiaries, ExactTarget, Inc. ("ExactTarget"), was added as a defendant in a purported class-action lawsuit that alleged that ExactTarget and one of its customers, Simply Fashion Stores, Ltd. ("Simply Fashion"), violated the Telephone Consumer Protection Act ("TCPA") as a result of Simply Fashion's text messaging campaigns and alleged failure to opt-out certain Simply Fashion customers from receiving messages. The complaint was subsequently amended to remove Simply Fashion as a defendant and the lawsuit is currently before the United States District Court for the Southern District of Indiana. The complaint seeks statutory damages and injunctive relief. The Company disputes the allegations of wrongdoing and intends to defend itself in this matter.

15. Related-Party Transactions

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

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

Since the Foundation's and Salesforce.org's inception, the Company has provided at no charge certain resources to those entities employees such as office space, furniture, equipment, facilities, services, and other resources. The value of these items was approximately \$4.3 million for the six months ended July 31, 2017.

Additionally, the Company allows Salesforce.org to donate subscriptions of the Company's services to other qualified non-profit organizations. The Company also allows Salesforce.org to resell the Company's service to non-profit organizations and certain education entities. The Company does not charge Salesforce.org for these subscriptions, therefore revenue from subscriptions provided to non-profit organizations is donated back to the community through charitable grants made by the Foundation and Salesforce.org. The value of the subscriptions sold by Salesforce.org pursuant to the reseller agreement, as amended, was approximately \$82.5 million for the six months ended July 31, 2017.



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

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

## Overview

We are a leading provider of enterprise cloud computing solutions, with a focus on customer relationship management, or CRM. We introduced our first CRM solution in 2000, and we have since expanded our service offerings with new editions, features and platform capabilities. Our core mission is to empower our customers to connect with their customers in entirely new ways through cloud, mobile, social, Internet of Things ("IoT") and artificial intelligence technologies.

Our Customer Success Platform - including sales force automation, customer service and support, marketing automation, digital commerce, community management, analytics, application development, IoT integration, collaborative productivity tools and our professional cloud services - provides the tools customers need to succeed in a digital world. Key elements of our strategy include:

- extend existing service offerings;
- cross sell and upsell;
- expand into new horizontal markets;
- target vertical markets;
- extend go-to-market capabilities;
- reduce customer attrition; and
- encourage the development of third-party applications on our cloud computing platforms.

Salesforce is also committed to a sustainable, low-carbon future, advancing equality and diversity, and fostering employee success. We try to integrate social good into everything we do. All of these goals align with our long-term growth strategy and financial and operational priorities.

We believe the factors that will influence our ability to achieve our objectives include: our prospective customers' willingness to migrate to enterprise cloud computing services; our ability to maintain a balanced portfolio of products and

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customers, the availability, performance and security of our service; our ability to continue to release, and gain customer acceptance of new and improved features; our ability to successfully integrate acquired businesses and technologies; successful customer adoption and utilization of our service; acceptance of our service in markets where we have few customers; the emergence of additional competitors in our market and improved product offerings by existing and new competitors; the location of new data centers that we operate as well as the new locations of services provided by third-party cloud computing platform providers; third-party developers' willingness to develop applications on our platforms; our ability to attract new personnel and retain and motivate current personnel; and general economic conditions which could affect our customers' ability and willingness to purchase our services, delay the customers' purchasing decision or affect attrition rates.

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

We also regularly evaluate acquisitions or investment opportunities in complementary businesses, joint ventures, services and technologies and intellectual property rights in an effort to expand our service offerings. We expect to continue to make such investments and acquisitions in the future and we plan to reinvest a significant portion of our incremental revenue in future periods to grow our business and continue our leadership role in the cloud computing industry. As part of our growth strategy, we are delivering innovative solutions in new categories, including analytics, e-commerce, artificial intelligence, IoT and collaborative productivity tools. We drive innovation organically and to a lesser extent through acquisitions, such as our July 2016 acquisition of Demandware, Inc. ("Demandware"), a digital commerce leader. We have a disciplined and thoughtful acquisition process where we routinely survey the industry landscape across a wide range of companies. As a result of our aggressive growth plans and integration of our previously acquired businesses, we have incurred significant expenses from equity awards and amortization of purchased intangibles, which have reduced our operating income. We remain focused on improving operating margins in fiscal 2018.

Our typical subscription contract term is 12 to 36 months, although terms range from one to 60 months, so during any fiscal reporting period only a subset of active subscription contracts is eligible for renewal. We calculate our attrition rate as of the end of each month. Our current attrition rate calculation does not include the Marketing and Commerce Cloud service offerings. Our attrition rate was between eight and nine percent as of July 31, 2017. While it is difficult to predict, we expect our attrition rate to remain consistent as we continue to expand our enterprise business and invest in customer success and related programs.

We expect marketing and sales costs, which were 46 percent for the six months ended July 31, 2017 and 2016 to continue to represent a substantial portion of total revenues in the future as we seek to grow our customer base, sell more products to existing customers, and continue to build greater brand awareness.

### Fiscal Year

Our fiscal year ends on January 31. References to fiscal 2018, for example, refer to the fiscal year ending January 31, 2018.

### Operating Segments

We operate as one operating segment. Operating segments are defined as components of an enterprise for which separate financial information is evaluated regularly by the chief operating decision maker, who in our case is the chief executive officer, in deciding how to allocate resources and assess performance. Over the past few years,

including fiscal 2017, we have completed a number of acquisitions. These acquisitions have allowed us to expand our offerings, presence and reach in various market segments of the enterprise cloud computing market. While we have offerings in multiple enterprise cloud computing market segments, including as a result of our acquisitions, our business operates in one operating segment because the majority of our offerings operate on a single platform and are deployed in an identical way, and our chief operating decision maker evaluates our financial information and resources and assesses the performance of these resources on a consolidated basis. Since we operate as one operating segment, all required financial segment information can be found in the consolidated financial statements.

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## Sources of Revenues

We derive our revenues from two sources: (1) subscription revenues, which are comprised of subscription fees from customers accessing our enterprise cloud computing services and from customers paying for additional support beyond the standard support that is included in the basic subscription fees; and (2) related professional services such as process mapping, project management, implementation services and other revenue. “Other revenue” consists primarily of training fees. Subscription and support revenues accounted for approximately 92 percent of our total revenues for the six months ended July 31, 2017. Subscription revenues are driven primarily by the number of paying subscribers, varying service types, the price of our service and renewals. We define a “customer” as a separate and distinct buying entity (e.g., a company, a distinct business unit of a large corporation, a partnership, etc.) that has entered into a contract to access our enterprise cloud computing services. We define a “subscription” as a unique user account purchased by a customer for use by its employees or other customer-authorized users, and we refer to each such user as a “subscriber.” The number of paying subscriptions at each of our customers ranges from one to hundreds of thousands. None of our customers accounted for more than five percent of our revenues during the six months ended July 31, 2017 and 2016.

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

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

In determining whether professional services can be accounted for separately from subscription and support revenues, we consider a number of factors, which are described in Note 1 “Summary of Business and Significant Accounting Policies.”

## Revenue by Cloud Service Offering

The information below is provided on a supplemental basis to give additional insight into the revenue performance of our individual core service offerings. All of the cloud offerings that we offer to customers are grouped into four major cloud service offerings. Subscription and support revenues consisted of the following (in millions):

|                               | Three Months   |           |                   | Six Months Ended |           |                   |
|-------------------------------|----------------|-----------|-------------------|------------------|-----------|-------------------|
|                               | Ended July 31, |           |                   | July 31,         |           |                   |
|                               | 2017           | 2016      | Variance- Percent | 2017             | 2016      | Variance- Percent |
| Sales Cloud                   | \$886.4        | \$754.9   | 17%               | \$1,716.0        | \$1,479.5 | 16%               |
| Service Cloud                 | 698.5          | 575.4     | 21%               | 1,349.7          | 1,115.5   | 21%               |
| Salesforce Platform and Other | 466.5          | 353.4     | 32%               | 897.6            | 679.3     | 32%               |
| Marketing and Commerce Cloud  | 317.1          | 202.4     | 57%               | 606.1            | 387.3     | 56%               |
| Total                         | \$2,368.5      | \$1,886.1 |                   | \$4,569.4        | \$3,661.6 |                   |

Subscription and support revenues from the Analytics Cloud, Community Cloud, IoT Cloud, and Salesforce Quip were not significant for the three and six months ended July 31, 2017. Analytics Cloud, IoT Cloud and Salesforce Quip revenue is included with Salesforce Platform and Other in the table above. Community Cloud revenue is included in either Sales Cloud, Service Cloud or Salesforce Platform and Other depending on the primary service offering purchased.

As required under U.S. GAAP, we recorded deferred revenue related to acquired contracts from Demandware at fair value on the date of acquisition. As a result, we did not recognize certain revenues related to these acquired contracts

that Demandware would have otherwise recorded as an independent entity. Of the \$606.1 million subscription and support revenue for Marketing and Commerce Cloud for the six months ended July 31, 2017, approximately \$96.9 million was attributed to our Demandware acquisition. To the extent Demandware contracts are renewed following the acquisition, we will recognize the revenues for the full values of the contracts over the respective contractual periods.

In situations where a customer purchases multiple cloud offerings, such as through an Enterprise License Agreement, we allocate the contract value to each core service offering based on the customer's estimated product demand plan and the service

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that was provided at the inception of the contract. We do not update these allocations based on actual product usage during the term of the contract. We have allocated approximately 14 percent of our total subscription and support revenues for the three and six months ended July 31, 2017 and 13 percent of our total subscription and support revenues for the three and six months ended July 31, 2016, based on customers' estimated product demand plans and these allocated amounts are included in the table above.

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

Our Sales Cloud service offering is our most widely distributed service offering and has historically been the largest contributor of subscription and support revenues. As a result, Sales Cloud has the most international exposure and foreign exchange rate exposure relative to the other cloud service offerings. Conversely, revenue for Marketing and Commerce Cloud is primarily derived from the Americas with little impact from foreign exchange rate movement. The revenue growth rates of each of our core service offerings fluctuate from quarter to quarter and over time. While we are a market leader in each core offering, we manage the total balanced product portfolio to deliver solutions to our customers. Accordingly, the revenue result for each cloud service offering is not necessarily indicative of the results to be expected for any subsequent quarter.

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

Deferred revenue primarily consists of billings to customers for our subscription service. Over 90 percent of the value of our billings to customers is for our subscription and support service. We generally invoice our customers in annual cycles. Approximately 80 percent of the value of all subscription and support related invoices, excluding Demandware related invoices, were issued with annual terms during the three months ended July 31, 2017 and 2016. We typically issue renewal invoices in advance of the renewal service period, and depending on timing, the initial invoice for the subscription and services contract and the subsequent renewal invoice may occur in different quarters. This may result in an increase in deferred revenue and accounts receivable. There is a disproportionate weighting toward annual billings in the fourth quarter, primarily as a result of large enterprise account buying patterns. Our fourth quarter has historically been our strongest quarter for new business and renewals. The year on year compounding effect of this seasonality in both billing patterns and overall new and renewal business causes the value of invoices that we generate in the fourth quarter for both new business and renewals to increase as a proportion of our total annual billings.

Accordingly, because of this billing activity, our first quarter is our largest collections and operating cash flow quarter. Unbilled Deferred Revenue, an Operational Measure

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

will change from year-to-year depending in part upon the number and dollar amount of subscription agreements at particular stages in their renewal cycle. Such fluctuations are not a reliable indicator of future revenues. Unbilled deferred revenue does not include minimum revenue commitments from indirect sales channels, as we recognize revenue, deferred revenue, and any unbilled deferred revenue upon sell-through to an end user customer. Unbilled deferred revenue also does not include any estimates for overage billings above a customer's minimum commitment.



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

|                           | July 31,<br>2017    | April 30,<br>2017   |                  |                   |
|---------------------------|---------------------|---------------------|------------------|-------------------|
| Fiscal 2018               |                     |                     |                  |                   |
| Accounts receivable, net  | \$1,569,322         | \$1,439,875         |                  |                   |
| Deferred revenue          | 4,818,634           | 5,042,652           |                  |                   |
| Operating cash flow (1)   | 331,269             | 1,229,584           |                  |                   |
| Unbilled deferred revenue | 10.4 bn             | 9.6 bn              |                  |                   |
|                           | January 31,<br>2017 | October 31,<br>2016 | July 31,<br>2016 | April 30,<br>2016 |
| Fiscal 2017               |                     |                     |                  |                   |
| Accounts receivable, net  | \$3,196,643         | \$1,281,425         | \$1,323,114      | \$1,192,965       |
| Deferred revenue (2)      | 5,542,802           | 3,495,133           | 3,823,561        | 4,006,914         |
| Operating cash flow (1)   | 706,146             | 154,312             | 250,678          | 1,051,062         |
| Unbilled deferred revenue | 9.0 bn              | 8.6 bn              | 8.0 bn           | 7.6 bn            |
|                           | January 31,<br>2016 | October 31,<br>2015 | July 31,<br>2015 | April 30,<br>2015 |
| Fiscal 2016               |                     |                     |                  |                   |
| Accounts receivable, net  | \$2,496,165         | \$1,060,726         | \$1,067,799      | \$926,381         |
| Deferred revenue (2)      | 4,291,553           | 2,846,510           | 3,034,991        | 3,056,820         |
| Operating cash flow (1)   | 470,208             | 162,514             | 304,278          | 735,081           |
| Unbilled deferred revenue | 7.1 bn              | 6.7 bn              | 6.2 bn           | 6.0 bn            |

(1) Operating cash flow represents net cash provided by operating activities for the three months ended in the periods stated above.

(2) Amounts include deferred revenue current and noncurrent

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### Cost of Revenues and Operating Expenses

#### Cost of Revenues

Cost of subscription and support revenues primarily consists of expenses related to delivering our service and providing support, the costs of data center capacity, depreciation or operating lease expense associated with computer equipment and software, allocated overhead, amortization expense associated with capitalized software related to our services and acquired developed technologies and certain fees paid to various third parties for the use of their technology, services and data. We allocate overhead such as information technology infrastructure, rent and occupancy charges based on headcount. Employee benefit costs and taxes are allocated based upon a percentage of total compensation expense. As such, general overhead expenses are reflected in each cost of revenue and operating expense category. Cost of professional services and other revenues consists primarily of employee-related costs associated with these services, including stock-based expenses, the cost of subcontractors, certain third-party fees and allocated overhead. The cost of providing professional services is higher as a percentage of the related revenue than for our enterprise cloud computing subscription service due to the direct labor costs and costs of subcontractors. We intend to continue to invest additional resources in our enterprise cloud computing services. For example, we have invested in additional database software and hardware and we plan to increase the capacity that we are able to offer globally through data centers and third-party infrastructure providers. As we acquire new businesses and technologies, the amortization expense associated with this activity will be included in cost of revenues. Additionally, as we enter into new contracts with third parties for the use of their technology, services or data, or as our sales volume grows, the fees paid to use such technology or services may increase. Finally, we expect the cost of professional services to be approximately in line with revenues from professional services as we believe this investment in professional services facilitates the adoption of our service offerings. The timing of these additional expenses will affect our cost of revenues, both in terms of absolute dollars and as a percentage of revenues, in the affected periods.

#### Research and Development

Research and development expenses consist primarily of salaries and related expenses, including stock-based expenses, the costs of our development and test data center and allocated overhead. We continue to focus our research and development efforts on adding new features and services, integrating acquired technologies, increasing the functionality and security and enhancing the ease of use of our enterprise cloud computing services. Our proprietary, scalable and secure multi-tenant architecture enables us to provide all of our customers with a service based on a single version of our application. As a result, we do not have to maintain multiple versions, which enables us to have relatively lower research and development expenses as compared to traditional enterprise software companies. We expect that in the future, research and development expenses will increase in absolute dollars and may increase as a percentage of total revenues as we invest in building the necessary employee and system infrastructure required to support the development of new, and improve existing, technologies and the integration of acquired businesses and technologies.

#### Marketing and Sales

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

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

#### General and Administrative

General and administrative expenses consist of salaries and related expenses, including stock-based expenses, for finance and accounting, legal, internal audit, human resources and management information systems personnel, legal costs, professional fees, other corporate expenses and allocated overhead. We expect that in the future, general and administrative expenses will increase in absolute dollars as we invest in our infrastructure and we incur additional

employee related costs, professional fees and insurance costs related to the growth of our business and international expansion. We expect general and administrative costs as a percentage of total revenues to either remain flat or decrease for the next several quarters. However, the timing of additional expenses in a particular quarter, both in terms of absolute dollars and as a percentage of revenues, will affect our general and administrative expenses.

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Stock-Based Expenses

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

During the six months ended July 31, 2017, we recognized stock-based expense related to our equity plans for employees and non-employee directors of \$508.1 million. As of July 31, 2017, the aggregate stock compensation remaining to be amortized to costs and expenses was approximately \$2.2 billion. We expect this stock compensation balance to be amortized as follows: \$487.8 million during the remaining six months of fiscal 2018; \$770.7 million during fiscal 2019; \$561.3 million during fiscal 2020; \$283.8 million during fiscal 2021; \$27.1 million during fiscal 2022 and \$25.2 million thereafter. The expected amortization reflects only outstanding stock awards as of July 31, 2017 and assumes no forfeiture activity. We expect to continue to issue stock-based awards to our employees in future periods.

Amortization of Purchased Intangibles from Business Combinations and the Purchase of 50 Fremont

Our cost of revenues, operating expenses and other expense include amortization of acquisition-related intangible assets, such as the amortization of the cost associated with an acquired company's developed technology, trade names and trademarks, customer lists, acquired leases and customer relationships. We expect this expense to fluctuate as we acquire more businesses and intangible assets become fully amortized.

Critical Accounting Policies and Estimates

There have been no significant changes in our critical accounting policies and estimates during the six months ended July 31, 2017 as compared to the critical accounting policies and estimates disclosed in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended January 31, 2017.

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## Results of Operations

Three Months Ended July 31, 2017 and 2016

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

|   | Three Months Ended July 31, |                | As a % of   |                |
|---|-----------------------------|----------------|-------------|----------------|
|   | 2017                        | Total Revenues | 2016        | Total Revenues |
| Revenues:   |                             |                |             |                |
| Subscription and support                                | \$2,368,499                 | 92 %           | \$1,886,080 | 93 %           |
| Professional services and other                         | 193,090                     | 8              | 150,538     | 7              |
| Total revenues  | 2,561,589                   | 100            | 2,036,618   | 100            |
| Cost of revenues (1)(2):                                |                             |                |             |                |
| Subscription and support                                | 493,879                     | 19             | 376,456     | 18             |
| Professional services and other                         | 176,788                     | 7              | 149,123     | 8              |
| Total cost of revenues                                  | 670,667                     | 26             | 525,579     | 26             |
| Gross profit  | 1,890,922                   | 74             | 1,511,039   | 74             |
| Operating expenses (1)(2):                              |                             |                |             |                |
| Research and development                                | 386,447                     | 15             | 291,506     | 14             |
| Marketing and sales                                     | 1,170,749                   | 46             | 934,931     | 46             |
| General and administrative                              | 282,933                     | 11             | 252,051     | 12             |
| Total operating expenses                                | 1,840,129                   | 72             | 1,478,488   | 72             |
| Income from operations                                  | 50,793                      | 2              | 32,551      | 2              |
| Investment income                                       | 8,754                       | 0              | 11,916      | 0              |
| Interest expense  | (21,629)                    | (1)            | (20,708)    | (1)            |
| Other income (expense) (1)                              | (7,465)                     | 0              | 524         | 0              |
| Gains from acquisitions of strategic investments        | 0                           | 0              | 0           | 0              |
| Income before benefit from (provision for) income taxes | 30,453                      | 1              | 24,283      | 1              |
| Benefit from (provision for) income taxes               | (12,717)                    | 0              | 205,339     | 10             |
| Net income  | \$17,736                    | 1 %            | \$229,622   | 11 %           |

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

|                             | Three Months Ended July 31, |                | As a % of |                |
|-----------------------------|-----------------------------|----------------|-----------|----------------|
|                             | 2017                        | Total Revenues | 2016      | Total Revenues |
| Cost of revenues            | \$43,483                    | 2 %            | \$25,544  | 1 %            |
| Marketing and sales         | 30,563                      | 1              | 23,151    | 1              |
| Other non-operating expense | 376                         | 0              | 642       | 0              |

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

|                            | Three Months Ended July 31, |                | As a % of |                |
|----------------------------|-----------------------------|----------------|-----------|----------------|
|                            | 2017                        | Total Revenues | 2016      | Total Revenues |
| Cost of revenues           | \$32,202                    | 1 %            | \$23,495  | 1 %            |
| Research and development   | 66,644                      | 3              | 38,624    | 2              |
| Marketing and sales        | 120,550                     | 5              | 86,323    | 4              |
| General and administrative | 37,089                      | 1              | 33,868    | 2              |

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## Revenues.

| (in thousands)                  | Three Months Ended |             | Variance  |         |
|---------------------------------|--------------------|-------------|-----------|---------|
|                                 | 2017               | 2016        | Dollars   | Percent |
| Subscription and support        | \$2,368,499        | \$1,886,080 | \$482,419 | 26%     |
| Professional services and other | 193,090            | 150,538     | 42,552    | 28%     |
| Total revenues                  | \$2,561,589        | \$2,036,618 | \$524,971 | 26%     |

Total revenues were \$2.6 billion for the three months ended July 31, 2017, compared to \$2.0 billion during the same period a year ago, an increase of \$525.0 million, or 26 percent. Subscription and support revenues were \$2.4 billion, or 92 percent of total revenues, for the three months ended July 31, 2017, compared to \$1.9 billion, or 93 percent of total revenues, during the same period a year ago, an increase of \$0.5 billion, or 26 percent. The increase in subscription and support revenues was primarily caused by volume-driven increases from new business, which includes new customers, upgrades and additional subscriptions from existing customers. Our acquisition of Demandware in July 2016 contributed \$51.1 million to the three months ended July 31, 2017. We continue to invest in a variety of customer programs and initiatives which, along with increasing enterprise adoption, have helped keep our attrition rate consistent as compared to the prior year. Consistent attrition rates play a role in our ability to maintain growth in our subscription and support revenues. Changes in the net price per user per month have not been a significant driver of revenue growth for the periods presented. Professional services and other revenues were \$193.1 million, or eight percent of total revenues, for the three months ended July 31, 2017, compared to \$150.5 million, or seven percent of total revenues, for the same period a year ago, an increase of \$42.6 million, or 28 percent. The increase in professional services and other revenues was due primarily to the higher demand for services from an increased number of customers.

Revenues by geography were as follows (in thousands):

|              | Three Months Ended July 31, |                                |             |                                |
|--------------|-----------------------------|--------------------------------|-------------|--------------------------------|
|              | 2017                        | As a % of<br>Total<br>Revenues | 2016        | As a % of<br>Total<br>Revenues |
| Americas     | \$1,854,169                 | 72 %                           | \$1,495,201 | 73 %                           |
| Europe       | 464,371                     | 18                             | 347,320     | 17                             |
| Asia Pacific | 243,049                     | 10                             | 194,097     | 10                             |
|              | \$2,561,589                 | 100 %                          | \$2,036,618 | 100 %                          |

Revenues by geography are determined based on the region of the Salesforce contracting entity, which may be different than the region of the customer. Americas revenue attributed to the United States was approximately 96 percent and 96 percent during the three months ended July 31, 2017 and 2016, respectively.

Revenues in Europe and Asia Pacific accounted for \$707.4 million, or 28 percent of total revenues, for the three months ended July 31, 2017, compared to \$541.4 million, or 27 percent of total revenues, during the same period a year ago, an increase of \$166.0 million, or 31 percent. The increase in revenues outside of the Americas was the result of the increasing acceptance of our services, our focus on marketing our services internationally and additional resources. Revenues outside of the Americas increased on a total dollar basis in the three months ended July 31, 2017 by \$6.5 million compared to the same period a year ago as a result of the weakening U.S. dollar.

## Cost of Revenues.

| (in thousands)                  | Three Months Ended |           | Variance  |  |
|---------------------------------|--------------------|-----------|-----------|--|
|                                 | 2017               | 2016      | Dollars   |  |
| Subscription and support        | \$493,879          | \$376,456 | \$117,423 |  |
| Professional services and other | 176,788            | 149,123   | 27,665    |  |
| Total cost of revenues          | \$670,667          | \$525,579 | \$145,088 |  |
| Percent of total revenues       | 26                 | % 26      | %         |  |

Cost of revenues was \$670.7 million, or 26 percent of total revenues, for the three months ended July 31, 2017, compared to \$525.6 million, or 26 percent of total revenues, during the same period a year ago, an increase of \$145.1 million. The increase in absolute dollars was primarily due to an increase of \$44.9 million in employee-related costs, an increase of \$8.7 million in stock-based expenses, an increase of \$51.9 million in service delivery costs, primarily due to our efforts to increase

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data center capacity, an increase of amortization of purchased intangible assets of \$17.9 million and an increase of \$7.5 million in allocated overhead. We have increased our headcount by 14 percent since July 31, 2016 to meet the higher demand for services from our customers and as a result of our fiscal 2017 acquisitions. We intend to continue to invest additional resources in our enterprise cloud computing services and data center capacity. We also plan to add additional employees in our professional services group to facilitate the adoption of our services. The timing of these expenses will affect our cost of revenues, both in terms of absolute dollars and as a percentage of revenues in future periods.

The cost of professional services and other revenues was \$176.8 million during the three months ended July 31, 2017 resulting in positive gross margins of \$16.3 million. The cost of professional services and other revenues was \$149.1 million during the three months ended July 31, 2016 resulting in positive gross margins of \$1.4 million. We expect the cost of professional services to be approximately in line with revenues from professional services in future fiscal quarters. We believe that this investment in professional services facilitates the adoption of our service offerings.

## Operating Expenses.

| (in thousands)             | Three Months Ended July 31, |             | Variance  |
|----------------------------|-----------------------------|-------------|-----------|
|                            | 2017                        | 2016        | Dollars   |
| Research and development   | \$386,447                   | \$291,506   | \$94,941  |
| Marketing and sales        | 1,170,749                   | 934,931     | 235,818   |
| General and administrative | 282,933                     | 252,051     | 30,882    |
| Total operating expenses   | \$1,840,129                 | \$1,478,488 | \$361,641 |
| Percent of total revenues  | 72                          | % 72        | %         |

Research and development expenses were \$386.4 million, or 15 percent of total revenues, for the three months ended July 31, 2017, compared to \$291.5 million, or 14 percent of total revenues, during the same period a year ago, an increase of \$94.9 million. The increase in absolute dollars was primarily due to an increase of approximately \$53.1 million in employee-related costs, an increase of \$28.0 million in stock-based expenses, an increase in our development and test data center costs and allocated overhead. We increased our research and development headcount by 14 percent since July 31, 2016 in order to improve and extend our service offerings, develop new technologies and integrate previously acquired companies, including our fiscal 2017 acquisitions. We expect that research and development expenses will increase in absolute dollars and may increase as a percentage of revenues in future periods as we continue to invest in additional employees and technology to support the development of new, and improve existing, technologies and the integration of acquired technologies.

Marketing and sales expenses were \$1.2 billion, or 46 percent of total revenues, for the three months ended July 31, 2017, compared to \$934.9 million, or 46 percent of total revenues, during the same period a year ago, an increase of \$235.8 million. The increase was primarily due to an increase of \$161.1 million in employee-related costs and amortization of deferred commissions, an increase of \$34.2 million in stock-based expenses, an increase in amortization of purchased intangible assets of \$7.4 million, an increase of \$15.6 million in advertising expenses and allocated overhead. Our marketing and sales headcount increased by 19 percent since July 31, 2016. The increase in headcount was primarily attributable to hiring additional sales personnel to focus on adding new customers and increasing penetration within our existing customer base.

General and administrative expenses were \$282.9 million, or 11 percent of total revenues, for the three months ended July 31, 2017, compared to \$252.1 million, or 12 percent of total revenues, during the same period a year ago, an increase of \$30.9 million. The increase was primarily due to an increase in employee-related costs. Our general and administrative headcount increased by 16 percent since July 31, 2016 as we added personnel to support our growth.

## Other income and expense.

| (in thousands)    | Three Months Ended July 31, |          | Variance  |
|-------------------|-----------------------------|----------|-----------|
|                   | 2017                        | 2016     | Dollars   |
| Investment income | \$8,754                     | \$11,916 | \$(3,162) |
| Interest expense  | (21,629)                    | (20,708) | (921)     |



Other income (expense) (7,465 ) 524 (7,989 )

Investment income consists of income on our cash and marketable securities balances. Investment income was \$8.8 million for the three months ended July 31, 2017 compared to \$11.9 million during the same period a year ago. The decrease was due to greater realized gains resulting from the sales of marketable securities in the three months ended July 31, 2016.

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Interest expense consists of interest on our convertible senior notes, capital leases, financing obligation related to 350 Mission, the loan assumed on 50 Fremont, revolving credit facility and the \$500.0 million term loan that was entered into in connection with our acquisition of Demandware. Interest expense was \$21.6 million for the three months ended July 31, 2017 compared to \$20.7 million during the same period a year ago.

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

Benefit from (provision for) income taxes.

| (in thousands)                            | Three Months Ended |           | Variance    |
|---|--------------------|-----------|-------------|
|   | July 31,           |           |             |
|   | 2017               | 2016      | Dollars     |
| Benefit from (provision for) income taxes | \$(12,717)         | \$205,339 | \$(218,056) |
| Effective tax rate                        | 42                 | % (846    | )%          |

We recognized a tax provision of \$12.7 million on a pretax income of \$30.5 million for the three months ended July 31, 2017. The tax provision recorded was primarily related to income taxes in profitable jurisdictions outside of the United States.

We recorded a tax benefit of \$205.3 million with a pretax income of \$24.3 million for the three months ended July 31, 2016. The most significant component of this tax amount was the discrete tax benefit of \$265.7 million from a partial release of the valuation allowance in connection with the acquisition of Demandware. The net deferred tax liability from the acquisition of Demandware provided a source of additional income to support the realizability of our pre-existing deferred tax assets and, as a result, we released a portion of our valuation allowance. The tax benefit associated with the release of the valuation allowance was partially offset by income taxes in profitable jurisdictions outside of the United States.

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Six Months Ended July 31, 2017 and 2016

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

|  | Six Months Ended July 31, |                                |             |                                |
|--|---------------------------|--------------------------------|-------------|--------------------------------|
|  | 2017                      | As a % of<br>Total<br>Revenues | 2016        | As a % of<br>Total<br>Revenues |
| <b>Revenues:</b>                                 |                           |                                |             |                                |
| Subscription and support                         | \$4,569,407               | 92 %                           | \$3,661,573 | 93 %                           |
| Professional services and other                  | 379,761                   | 8                              | 291,648     | 7                              |
| Total revenues                                   | 4,949,168                 | 100                            | 3,953,221   | 100                            |
| <b>Cost of revenues (1)(2):</b>                  |                           |                                |             |                                |
| Subscription and support                         | 956,800                   | 19                             | 727,557     | 18                             |
| Professional services and other                  | 364,422                   | 8                              | 295,003     | 8                              |
| Total cost of revenues                           | 1,321,222                 | 27                             | 1,022,560   | 26                             |
| Gross profit                                     | 3,627,946                 | 73                             | 2,930,661   | 74                             |
| <b>Operating expenses (1)(2):</b>                |                           |                                |             |                                |
| Research and development                         | 762,528                   | 15                             | 552,476     | 14                             |
| Marketing and sales                              | 2,280,253                 | 46                             | 1,830,791   | 46                             |
| General and administrative                       | 543,254                   | 11                             | 462,857     | 12                             |
| Total operating expenses                         | 3,586,035                 | 72                             | 2,846,124   | 72                             |
| Income from operations                           | 41,911                    | 1                              | 84,537      | 2                              |
| Investment income                                | 14,020                    | 0                              | 20,038      | 1                              |
| Interest expense                                 | (43,825)                  | (1)                            | (42,719)    | (1)                            |
| Other income (expense) (1)                       | (4,616)                   | 0                              | (13,282)    | 0                              |
| Gains from acquisitions of strategic investments | 0                         | 0                              | 12,864      | 0                              |
| Income before benefit from income taxes          | 7,490                     | 0                              | 61,438      | 2                              |
| Benefit from income taxes                        | 1,039                     | 0                              | 206,943     | 5                              |
| Net income                                       | \$8,529                   | 0 %                            | \$268,381   | 7 %                            |

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

|                             | Six Months Ended July 31, |                                |          |                                |
|-----------------------------|---------------------------|--------------------------------|----------|--------------------------------|
|                             | 2017                      | As a % of<br>Total<br>Revenues | 2016     | As a % of<br>Total<br>Revenues |
| Cost of revenues            | \$87,069                  | 2 %                            | \$47,759 | 1 %                            |
| Marketing and sales         | 61,207                    | 1 %                            | 38,537   | 1                              |
| Other non-operating expense | 751                       | 0                              | 1,348    | 0                              |

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

|                            | Six Months Ended July 31, |                                |          |                                |
|----------------------------|---------------------------|--------------------------------|----------|--------------------------------|
|                            | 2017                      | As a % of<br>Total<br>Revenues | 2016     | As a % of<br>Total<br>Revenues |
| Cost of revenues           | \$63,712                  | 1 %                            | \$50,129 | 1 %                            |
| Research and development   | 130,559                   | 3                              | 73,792   | 2                              |
| Marketing and sales        | 239,546                   | 5                              | 181,797  | 5                              |
| General and administrative | 74,237                    | 1                              | 65,511   | 1                              |

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## Revenues.

| (in thousands)                  | Six Months Ended July 31, |             | Variance  |         |
|---------------------------------|---------------------------|-------------|-----------|---------|
|                                 | 2017                      | 2016        | Dollars   | Percent |
| Subscription and support        | \$4,569,407               | \$3,661,573 | \$907,834 | 25%     |
| Professional services and other | 379,761                   | 291,648     | 88,113    | 30%     |
| Total revenues                  | \$4,949,168               | \$3,953,221 | \$995,947 | 25%     |

Total revenues were \$4.9 billion for the six months ended July 31, 2017, compared to \$4.0 billion during the same period a year ago, an increase of \$1.0 billion, or 25 percent. Subscription and support revenues were \$4.6 billion, or 92 percent of total revenues, for the six months ended July 31, 2017, compared to \$3.7 billion, or 93 percent of total revenues, during the same period a year ago, an increase of \$0.9 billion, or 25 percent. The increase in subscription and support revenues was primarily caused by volume-driven increases from new business, which includes new customers, upgrades and additional subscriptions from existing customers. Our acquisition of Demandware in July 2016 contributed \$96.9 million to the six months ended July 31, 2017. This was offset by a reduction in subscription revenues of approximately \$20.0 million as a result of one less day in the six months ended July 31, 2017 compared to the six months ended July 31, 2016. We continue to invest in a variety of customer programs and initiatives which, along with increasing enterprise adoption, have helped keep our attrition rate consistent as compared to the prior year. Consistent attrition rates play a role in our ability to maintain growth in our subscription and support revenues. Changes in the net price per user per month have not been a significant driver of revenue growth for the periods presented. Professional services and other revenues were \$379.8 million, or eight percent of total revenues, for the six months ended July 31, 2017, compared to \$291.6 million, or seven percent of total revenues, for the same period a year ago, an increase of \$88.1 million, or 30 percent. The increase in professional services and other revenues was due primarily to the higher demand for services from an increased number of customers.

Revenues by geography were as follows (in thousands):

|              | Six Months Ended July 31, |                          |             |                          |
|--------------|---------------------------|--------------------------|-------------|--------------------------|
|              | 2017                      | As a % of Total Revenues | 2016        | As a % of Total Revenues |
| Americas     | \$3,609,527               | 73 %                     | \$2,908,430 | 74 %                     |
| Europe       | 873,986                   | 18                       | 675,174     | 17                       |
| Asia Pacific | 465,655                   | 9                        | 369,617     | 9                        |
|              | \$4,949,168               | 100 %                    | \$3,953,221 | 100 %                    |

Revenues by geography are determined based on the region of the salesforce contracting entity, which may be different than the region of the customer. Americas revenue attributed to the United States was approximately 96 percent and 96 percent during the six months ended July 31, 2017 and 2016, respectively.

Revenues in Europe and Asia Pacific accounted for \$1.3 billion, or 27 percent of total revenues, for the six months ended July 31, 2017, compared to \$1.0 billion, or 26 percent of total revenues, during the same period a year ago, an increase of \$294.9 million, or 28 percent. The increase in revenues outside of the Americas was the result of the increasing acceptance of our services, our focus on marketing our services internationally and additional resources. The impact of foreign exchange rates did not significantly impact revenues in the six months ended July 31, 2017 compared to the same period a year ago.

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## Cost of Revenues.

| (in thousands)                  | Six Months Ended July 31, |             | Variance  |
|---------------------------------|---------------------------|-------------|-----------|
|                                 | 2017                      | 2016        | Dollars   |
| Subscription and support        | \$956,800                 | \$727,557   | \$229,243 |
| Professional services and other | 364,422                   | 295,003     | 69,419    |
| Total cost of revenues          | \$1,321,222               | \$1,022,560 | \$298,662 |
| Percent of total revenues       | 27                        | % 26        | %         |

Cost of revenues was \$1.3 billion, or 27 percent of total revenues, for the six months ended July 31, 2017, compared to \$1.0 billion, or 26 percent of total revenues, during the same period a year ago, an increase of \$298.7 million. The increase in absolute dollars was primarily due to an increase of \$107.4 million in employee-related costs, an increase of \$13.6 million in stock-based expenses, an increase of \$90.0 million in service delivery costs, primarily due to our efforts to increase data center capacity, an increase of amortization of purchased intangible assets of \$39.3 million and an increase of \$18.2 million in allocated overhead. We have increased our headcount by 14 percent since July 31, 2016 to meet the higher demand for services from our customers and as a result of our fiscal 2017 acquisitions. We intend to continue to invest additional resources in our enterprise cloud computing services and data center capacity. We also plan to add additional employees in our professional services group to facilitate the adoption of our services. The timing of these expenses will affect our cost of revenues, both in terms of absolute dollars and as a percentage of revenues in future periods.

The cost of professional services and other revenues was \$364.4 million during the six months ended July 31, 2017 resulting in positive gross margin of \$15.3 million. The cost of professional services and other revenues was \$295.0 million during the six months ended July 31, 2016 resulting in negative gross margins of \$3.4 million. We expect the cost of professional services to be approximately in line with revenues from professional services in future fiscal quarters. We believe that this investment in professional services facilitates the adoption of our service offerings.

## Operating Expenses.

| (in thousands)             | Six Months Ended July 31, |             | Variance  |
|----------------------------|---------------------------|-------------|-----------|
|                            | 2017                      | 2016        | Dollars   |
| Research and development   | \$762,528                 | \$552,476   | \$210,052 |
| Marketing and sales        | 2,280,253                 | 1,830,791   | 449,462   |
| General and administrative | 543,254                   | 462,857     | 80,397    |
| Total operating expenses   | \$3,586,035               | \$2,846,124 | \$739,911 |
| Percent of total revenues  | 72                        | % 72        | %         |

Research and development expenses were \$762.5 million, or 15 percent of total revenues, for the six months ended July 31, 2017, compared to \$552.5 million, or 14 percent of total revenues, during the same period a year ago, an increase of \$210.1 million. The increase in absolute dollars was primarily due to an increase of approximately \$116.8 million in employee-related costs, an increase of \$56.8 million in stock-based expenses, an increase in our development and test data center costs and allocated overhead. We increased our research and development headcount by 14 percent since July 31, 2016 in order to improve and extend our service offerings, develop new technologies and integrate previously acquired companies, including our fiscal 2017 acquisitions. We expect that research and development expenses will increase in absolute dollars and may increase as a percentage of revenues in future periods as we continue to invest in additional employees and technology to support the development of new, and improve existing, technologies and the integration of acquired technologies.

Marketing and sales expenses were \$2.3 billion, or 46 percent of total revenues, for the six months ended July 31, 2017, compared to \$1.8 billion, or 46 percent of total revenues, during the same period a year ago, an increase of \$449.5 million. The change was primarily due to an increase of \$310.3 million in employee-related costs and amortization of deferred commissions, an increase of \$57.7 million in stock-based expenses, an increase in amortization of purchased intangible assets of \$22.7 million, an increase of \$22.8 million in advertising expenses and allocated overhead. Our marketing and sales headcount increased by 19 percent since July 31, 2016. The increase in headcount was primarily attributable to hiring additional sales personnel to focus on adding new customers and increasing penetration within our existing customer base.

General and administrative expenses were \$543.3 million, or 11 percent of total revenues, for the six months ended July 31, 2017, compared to \$462.9 million, or 12 percent of total revenues, during the same period a year ago, an increase of \$80.4

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million. The increase was primarily due to an increase in employee-related costs. Our general and administrative headcount increased by 16 percent since July 31, 2016 as we added personnel to support our growth. Other income and expense.

| (in thousands)                                   | Six Months Ended |           | Variance<br>Dollars |
|--|------------------|-----------|---------------------|
|  | July 31,<br>2017 | 2016      |                     |
| Investment income                                | \$14,020         | \$20,038  | \$(6,018)           |
| Interest expense                                 | (43,825 )        | (42,719 ) | (1,106 )            |
| Other income (expense)                           | (4,616 )         | (13,282 ) | 8,666               |
| Gains from acquisitions of strategic investments | 0                | 12,864    | (12,864)            |

Investment income consists of income on our cash and marketable securities balances. Investment income was \$14.0 million for the six months ended July 31, 2017 and was \$20.0 million during the same period a year ago. The decrease was due to lower realized gains from the sales of marketable securities.

Interest expense consists of interest on our convertible senior notes, capital leases, financing obligation related to 350 Mission, the loan assumed on 50 Fremont, revolving credit facility and the \$500.0 million term loan that was entered into in connection with our acquisition of Demandware. Interest expense was \$43.8 million for the six months ended July 31, 2017 and was \$42.7 million during the same period a year ago.

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

Gains from acquisitions of strategic investments represents gains on sales of strategic investments when we acquire an entity in which we previously held a strategic investment. The difference between the fair value of the shares as of the date of the acquisition and the carrying value of the strategic investment is recorded as a gain or loss and disclosed separately within the statements of operations.

Benefit from income taxes.

| (in thousands)            | Six Months Ended July |           | Variance<br>Dollars |
|---------------------------|-----------------------|-----------|---------------------|
|                           | 2017                  | 2016      |                     |
| Benefit from income taxes | \$1,039               | \$206,943 | \$(205,904)         |
| Effective tax rate        | (14 )%                | (337 )%   |                     |

We recognized a tax benefit of \$1.0 million on a pretax income of \$7.5 million for the six months ended July 31, 2017. We recorded year-to-date tax provision primarily from profitable jurisdictions outside of the United States; however, due to various discrete tax benefits including excess tax benefits from stock options and vesting of restricted stocks, the result was a small net tax benefit.

We recorded a tax benefit of \$206.9 million with a pretax income of \$61.4 million for the six months ended July 31, 2016. The most significant component of this tax amount was the discrete tax benefit of \$265.7 million from a partial release of the valuation allowance in connection with the acquisition of Demandware. The net deferred tax liability from the acquisition of Demandware provided a source of additional income to support the realizability of our preexisting deferred tax assets and, as a result, we released a portion of our tax valuation allowance. The tax benefit associated with the release of the valuation allowance was partially offset by income taxes in profitable jurisdictions outside of the United States.

#### Liquidity and Capital Resources

At July 31, 2017, our principal sources of liquidity were cash, cash equivalents and marketable securities totaling \$3.5 billion and accounts receivable of \$1.6 billion. Our cash, cash equivalents and marketable securities are comprised primarily of corporate notes and obligations, U.S. treasury securities, asset backed securities, foreign government obligations, mortgage backed obligations, time deposits, money market mutual funds and municipal securities. Net cash provided by operating activities was \$1.6 billion during the six months ended July 31, 2017 and \$1.3 billion during the same period a year ago. Cash provided by operating activities has historically been affected by the amount of net income adjusted for non-cash expense items such as depreciation and amortization; amortization of purchased intangibles from





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business combinations; amortization of debt discount; the expense associated with stock-based awards; gains from acquisitions of strategic investments; the timing of employee related costs including commissions and bonus payments; the timing of payments against accounts payable, accrued expenses and other current liabilities; the timing of collections from our customers, which is our largest source of operating cash flows; the timing of business combination activity and the related integration and transaction costs; and changes in working capital accounts.

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

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

We generally invoice our customers for our subscription and services contracts in advance in annual installments. We typically issue renewal invoices in advance of the renewal service period, and depending on timing, the initial invoice for the subscription and services contract and the subsequent renewal invoice may occur in different quarters. Such invoice amounts are initially reflected in accounts receivable and deferred revenue, which is reflected on the balance sheets. The operating cash flow benefit of increased billing activity generally occurs in the subsequent quarter when we collect from our customers. As such, our first quarter is our largest collections and operating cash flow quarter. Net cash used in investing activities was \$1.3 billion during the six months ended July 31, 2017 and \$2.0 billion during the same period a year ago. The net cash used in investing activities during the six months ended July 31, 2017 primarily related to purchases of marketable securities of approximately \$1.2 billion, new office build outs and strategic and capital investments which were offset by the cash inflows for the period from the sales of marketable securities of \$243.5 million.

Net cash provided by financing activities was \$67.6 million during the six months ended July 31, 2017 as compared to \$655.8 million during the same period a year ago. Net cash provided by financing activities during the six months ended July 31, 2017 consisted primarily of \$342.8 million from proceeds from equity plans offset by \$200.0 million repayment of the revolving credit facility and \$75.2 million of principal payments on capital lease obligations.

In March 2013, we issued at par value \$1.15 billion of 0.25% convertible senior notes (“0.25% Senior Notes”), due April 1, 2018, unless earlier purchased by us or converted. The Notes will be convertible if during any 20 trading days during the 30 consecutive trading days of any fiscal quarter, our common stock trades at a price exceeding 130% of the conversion price of \$66.44 per share applicable to the Notes. The Notes are classified as a current liability on our consolidated balance sheet as of July 31, 2017 as they are due within one year. For the 20 trading days during the 30 consecutive trading days ended July 31, 2017, our common stock traded at a price exceeding 130% of the conversion price of \$66.44 per share applicable to the 0.25% Senior Notes. Accordingly, the 0.25% Senior Notes will be convertible at the holders’ option for the quarter ending October 31, 2017. As of July 31, 2017 the remaining principal balance of the 0.25% Senior Notes outstanding is \$1.15 billion.

In July 2016, we entered into a credit agreement (“Revolving Loan Credit Agreement”), which provides for a \$1.0 billion unsecured revolving credit facility (“Credit Facility”) that matures in July 2021. We may use any future borrowings under the Credit Facility for refinancing other indebtedness, working capital, capital expenditures and other general corporate purposes, including permitted acquisitions. We may borrow amounts under the Credit Facility at any time during the term of the Revolving Loan Credit Agreement. As of July 31, 2017, we had no outstanding borrowings under the Credit Facility.

The Revolving Loan Credit Agreement contains certain customary affirmative and negative covenants, including a consolidated leverage ratio covenant, a consolidated interest coverage ratio covenant, a limit on our ability to incur additional indebtedness, dispose of assets, make certain acquisition transactions, pay dividends or distributions, and certain other restrictions on our activities each defined specifically in the Revolving Loan Credit Agreement. We were in compliance with the Revolving Loan Credit Agreement's covenants as of July 31, 2017.

In July 2016, in order to partially finance the acquisition of Demandware, we entered into a \$500.0 million term loan ("Term Loan") which matures in July 2019. As of July 31, 2017, the noncurrent outstanding principal portion of the Term Loan was \$500.0 million.

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As of July 31, 2017, we have a total of \$86.6 million in letters of credit outstanding in favor of certain landlords for office space. To date, no amounts have been drawn against the letters of credit, which renew annually and expire at various dates through December 2030.

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

Our principal commitments consist of obligations under leases for office space, co-location data center facilities and our development and test data center, as well as leases for computer equipment, software, furniture and fixtures. At July 31, 2017, the future non-cancelable minimum payments under these commitments were as follows (in thousands):

|  | Capital<br>Leases | Operating<br>Leases | Financing<br>Obligation<br>- Leased<br>Facility |
|--|-------------------|---------------------|---|
| Fiscal Period:                             |                   |                     |   |
| Remaining six months of Fiscal 2018        | \$29,450          | \$273,221           | \$ 10,792                                       |
| Fiscal 2019                                | 115,834           | 505,431             | 21,881  |
| Fiscal 2020                                | 201,618           | 433,161             | 22,325  |
| Fiscal 2021                                | 75                | 320,162             | 22,770  |
| Fiscal 2022                                | 37                | 276,137             | 23,214  |
| Thereafter                                 | 3                 | 1,402,990           | 210,713   |
| Total minimum lease payments               | 347,017           | \$3,211,102         | \$ 311,695                                      |
| Less: amount representing interest         | (23,554 )         |                     |   |
| Present value of capital lease obligations | \$323,463         |                     |   |

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

The financing obligation above represents the total obligation for our lease of approximately 445,000 rentable square feet of office space at 350 Mission St. ("350 Mission") in San Francisco, California. As of July 31, 2017, \$219.3 million of the total obligation noted above was recorded to Financing obligation - leased facility, of which the current portion is included in "Accounts payable, accrued expenses and other liabilities" and the noncurrent portion is included in "Other noncurrent liabilities" on the consolidated balance sheets.

In April 2016, we entered into an agreement with a third-party provider for certain infrastructure services for a period of four years. We paid \$96.0 million in connection with this agreement during the six months ended July 31, 2017. The agreement further provides that we will pay an additional \$108.0 million in fiscal 2019 and \$126.0 million in fiscal 2020.

In July 2017, we entered into an agreement with a third-party to obtain the exclusive naming rights for the project formerly known as the Transbay Transit Terminal in San Francisco for a period of 25 years. We paid a non-refundable fee of \$1.0 million upon execution of the agreement and we are obligated to pay approximately \$4.4 million each year over the life of the agreement. The agreement may be terminated by us without cause upon satisfaction of certain conditions.

During the remaining six months of fiscal 2018 and in future fiscal years, we expect to continue to make additional investments in our infrastructure to scale our operations and increase productivity. We plan to upgrade or replace various internal systems to scale with the overall growth of the Company. Additionally, we expect capital expenditures to be higher in absolute dollars and remain consistent as a percentage of total revenues in future periods as a result of continued office build-outs, other leasehold improvements and data center investments.

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

our ability to complete subsequent acquisitions or investments, and which may affect the risks of owning our common stock.

We believe our existing cash, cash equivalents, marketable securities, cash provided by operating activities and, if necessary, our borrowing capacity under our Credit Facility will be sufficient to meet our working capital, capital expenditure and debt repayment needs over the next 12 months.

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New Accounting Pronouncements

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

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency Exchange Risk

We primarily conduct our business in the following locations: the United States, Europe, Canada, Asia Pacific and Japan. The expanding global scope of our business exposes us to risk of fluctuations in foreign currency markets. This exposure is the result of selling in multiple currencies, growth in our international investments, including data center expansion, additional headcount in foreign countries, and operating in countries where the functional currency is the local currency. Specifically, our results of operations and cash flows are subject to fluctuations in the following currencies: the Euro, British Pound Sterling, Canadian Dollar, Australian Dollar and Japanese Yen against the United States Dollar (“USD”). These exposures may change over time as business practices evolve and economic conditions change. Changes in foreign currency exchange rates could have an adverse impact on our financial results and cash flows.

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

Foreign Currency Transaction Risk

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

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

Foreign Currency Translation Risk

Fluctuations in foreign currencies impact the amount of total assets, liabilities, revenues, operating expenses and cash flows that we report for our foreign subsidiaries upon the translation of these amounts into USD. As the USD fluctuated against certain international currencies over the past several months, the amounts of revenue and deferred revenue that we reported in USD for foreign subsidiaries that transact in international currencies were slightly higher relative to what we would have reported using a constant currency rate.

Interest Rate Sensitivity

We had cash, cash equivalents and marketable securities totaling \$3.5 billion at July 31, 2017. This amount was invested primarily in money market funds, time deposits, corporate notes and bonds, government securities and other debt securities with credit ratings of at least BBB or better. The cash, cash equivalents and marketable securities are held for general corporate purposes including possible acquisitions of, or investments in, complementary businesses, services or technologies, working capital and capital expenditures. Our investments are made for capital preservation purposes. We do not enter into investments for trading or speculative purposes.

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

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An immediate increase or decrease in interest rates of 100-basis points at July 31, 2017 could result in a \$29.8 million market value reduction or increase of the same amount. This estimate is based on a sensitivity model that measures market value changes when changes in interest rates occur. Fluctuations in the value of our investment securities caused by a change in interest rates (gains or losses on the carrying value) are recorded in other comprehensive income, and are realized only if we sell the underlying securities.

At January 31, 2017, we had cash, cash equivalents and marketable securities totaling \$2.2 billion. The fixed-income portfolio was also subject to interest rate risk. Changes in interest rates of 100-basis points would have resulted in market value changes of \$13.0 million.

**Market Risk and Market Interest Risk**

We deposit our cash with multiple financial institutions.

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

The Notes have a fixed annual interest rate of 0.25% and therefore, we do not have economic interest rate exposure on the Notes. However, the value of the Notes is exposed to interest rate risk. Generally, the fair value of our fixed interest rate Notes will increase as interest rates fall and decrease as interest rates rise. In addition, the fair value of our Notes is affected by our stock price. The principal balance of our Notes was \$1.15 billion as of July 31, 2017. The total estimated fair value of our Notes at July 31, 2017 was \$1.6 billion. The fair value was determined based on the closing trading price per \$100 of the Notes as of the last day of trading for the second quarter of fiscal 2018, which was \$90.80.

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

The Borrowings under the Credit Facility bear interest, at our option, at a base rate plus a spread of 0.00% to 0.75% or an adjusted LIBOR rate plus a spread of 1.00% to 1.75%, in each case with such spread being determined based on our consolidated leverage ratio for the preceding four fiscal quarter period. Regardless of what amounts, if any, are outstanding under the revolving credit facility, we are also obligated to pay an ongoing commitment fee on undrawn amounts at a rate of 0.125% to 0.25%, with such rate being based on our consolidated leverage ratio for the preceding four fiscal quarter period, payable in arrears quarterly. As of July 31, 2017 there was no outstanding borrowing amount under the Credit Facility.

In February 2015, we assumed a \$200.0 million loan with the acquisition of 50 Fremont (“Loan”). The Loan bears an interest rate of 3.75% per annum and is due in June 2023. For the remainder of fiscal 2018, the Loan requires interest only payments. Beginning in fiscal 2019, principal and interest payments are required, with the remaining principal due at maturity. The Loan can be prepaid at any time subject to a yield maintenance fee. The agreement governing the Loan contains certain customary affirmative and negative covenants that we were in compliance with as of July 31, 2017.

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

By entering into the Term Loan, we have assumed risks associated with variable interest rates based upon a variable base rate or LIBOR. The weighted average interest rate on the Term Loan was 2.1% as of July 31, 2017. Changes in the overall level of interest rates affect the interest expense that we recognize in our statements of operations.



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

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We have an investment portfolio that includes strategic investments in public and privately held companies, which range from early-stage companies to more mature companies with established revenue streams and business models. Our portfolio consists of investments in over 190 privately held companies and four public companies, primarily comprised of independent software vendors and system integrators. Our investments in these companies range from \$0.2 million to over \$90.0 million, with 15 investments individually equal to or in excess of approximately \$10.0 million.

We invest in early-to-late stage enterprise cloud companies for strategic reasons and to support key business initiatives to grow our ecosystem of partners and accelerate the adoption of cloud technologies. We invest in both domestic and international companies and currently hold investments in all of our regions: the Americas, Europe, and Asia Pacific. We plan to continue to invest in these types of strategic investments, including in companies representing targeted geographies and targeted business and technological initiatives, as opportunities arise that we find attractive

The primary purpose of our investments is to create an ecosystem of enterprise cloud companies and accelerate the growth of technology startups and system integrators. Therefore, we continually evaluate our investments in publicly traded companies, post public offering, for exit strategies. Our ability to sell these investments may be impacted by contractual obligations to hold the securities for a set period of time after a public offering. Currently, one of our publicly held investments is subject to such a contractual obligation, which expires in the third quarter of fiscal 2018. Our strategic investments in privately held companies are primarily in preferred stock of the respective investees and therefore provide us with liquidation preferences in the event there are certain liquidation events. When our ownership interests are less than 20 percent and we do not have the ability to exert significant influence, we account for investments in non-marketable debt and equity securities of the privately held companies using the cost method of accounting. Otherwise, we account for the investments using the equity method of accounting.

As of July 31, 2017 and January 31, 2017 the carrying value of our investments in privately held companies was \$538.5 million and \$526.0 million, respectively. The estimated fair value of our investments in privately held companies was \$762.1 million and \$758.3 million as of July 31, 2017 and January 31, 2017, respectively. The financial success of our investment in any company is typically dependent on a liquidity event, such as a public offering, acquisition or other favorable market event reflecting appreciation to the cost of our initial investment. If we determine that any of our investments in such companies have experienced a decline in fair value, we may be required to record an impairment that is other-than-temporary, which could be material. We have in the past recorded other than temporary impairments or written off the full value of specific investments. Similar situations could occur in the future and negatively impact our financial results. All of our investments are subject to a risk of partial or total loss of investment capital.

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ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

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

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

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

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

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

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

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

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

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

We make a provision for a liability relating to legal matters when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, estimated settlements, legal rulings, advice of legal counsel and other information and events pertaining to a particular matter. The outcomes of our legal proceedings and other contingencies are, however, inherently unpredictable and subject to significant uncertainties. As a result, we may not be able to reasonably estimate the amount or range of possible losses in excess of any amounts accrued, including losses that could arise as a result of application of non-monetary remedies, with respect to any contingencies, and our estimates may not prove to be accurate.

In our opinion, resolution of all current matters is not expected to have a material adverse impact on our consolidated results of operations, cash flows or financial position. However, depending on the nature and timing of a given dispute or other contingency, an unfavorable resolution could materially affect our current or future results of operations or cash flows, or both, in a particular quarter.

See also Note 14, "Legal Proceedings and Claims" of the Notes to Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q, which is incorporated herein by reference.

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ITEM 1A. RISK FACTORS

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

Risks Related to Our Business and Industry

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

Our services involve the storage and transmission of our customers' and our customers' customers' proprietary and other sensitive data, including financial information and other personally identifiable information. Security breaches could expose us to a risk of loss of this information, litigation and possible liability. While we have security measures in place, they may be breached as a result of third-party action, including intentional misconduct by computer hackers, employee error, malfeasance or otherwise and result in someone obtaining unauthorized access to our IT systems, our customers' data or our data, including our intellectual property and other confidential business information.

Additionally, third parties may attempt to fraudulently induce employees or customers into disclosing sensitive information such as user names, passwords or other information in order to gain access to our customers' data, our data or our IT systems. Because the techniques used to obtain unauthorized access, or to sabotage systems, change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. In addition, our customers may authorize third-party technology providers to access their customer data, and some of our customers may not have adequate security measures in place to protect their data that is stored on our servers. Because we do not control our customers or third-party technology providers, or the processing of such data by third-party technology providers, we cannot ensure the integrity or security of such transmissions or processing. Malicious third parties may also conduct attacks designed to temporarily deny customers access to our services. Any security breach could result in a loss of confidence in the security of our services, damage our reputation, negatively impact our future sales, disrupt our business and lead to legal liability.

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

Interruptions or delays in services from third-parties, including data center hosting facilities, cloud computing platform providers or other hardware and software vendors could impair the delivery of our services and harm our business.

We currently serve our customers from third-party data center hosting facilities and cloud computing platform providers located in the United States and other countries. We also rely on computer hardware purchased or leased from, software licensed from, and cloud computing platforms provided by, third parties in order to offer our services, including database software, hardware and data from a variety of vendors. Any damage to, or failure of our systems

generally, including the systems of our third-party platform providers, could result in interruptions in our services. We have from time to time experienced interruptions in our services and such interruptions may occur in the future. Interruptions in our services may reduce our revenue, cause us to issue credits or pay penalties, cause customers to terminate their subscriptions and adversely affect our attrition rates and our ability to attract new customers, all of which would reduce our revenue. Our business would also be harmed if our customers and potential customers believe our services are unreliable.

We use a range of disaster recovery and business continuity arrangements. For many of our offerings, our production environment and customers' data are replicated in near real-time in a separate facility located elsewhere. Certain offerings, including some offerings of companies added through acquisitions, may be served through alternate facilities or arrangements. We do not control the operation of any of these facilities, and they may be vulnerable to damage or interruption from earthquakes, floods, fires, power loss, telecommunications failures and similar events. They may also be subject to break-ins, sabotage, intentional acts of vandalism and similar misconduct, as well as local administrative actions, changes to legal or

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permitting requirements and litigation to stop, limit or delay operation. Despite precautions taken at these facilities, such as disaster recovery and business continuity arrangements, the occurrence of a natural disaster or an act of terrorism, a decision to close the facilities without adequate notice or other unanticipated problems at these facilities could result in lengthy interruptions in our services.

These hardware, software, data and cloud computing platforms may not continue to be available at reasonable prices, on commercially reasonable terms or at all. Any loss of the right to use any of these hardware, software or cloud computing platforms could significantly increase our expenses and otherwise result in delays in the provisioning of our services until equivalent technology is either developed by us, or, if available, is identified, obtained through purchase or license and integrated into our services.

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

Privacy concerns and laws such as the European Union's General Data Protection Regulation, evolving regulation of cloud computing, cross-border data transfer restrictions and other domestic or foreign regulations may limit the use and adoption of our services and adversely affect our business.

Regulation related to the provision of services over the Internet is evolving, as federal, state and foreign governments continue to adopt new, or modify existing, laws and regulations addressing data privacy and the collection, processing, storage, transfer and use of data. In some cases, new data privacy laws and regulations, such as the European Union's ("EU") General Data Protection Regulation that takes effect in May 2018 and an amended Act on the Protection of Personal Information in Japan, impose new obligations directly on Salesforce as both a data controller and a data processor, as well as on many of our customers. These new laws may require us to make changes to our services to enable Salesforce and/or our customers to meet the new legal requirements, and may also increase our potential liability exposure through higher potential penalties for non-compliance. Further, laws such as the European Union's proposed e-Privacy Regulation are increasingly aimed at the use of personal information for marketing purposes, and the tracking of individuals' online activities. These new or proposed these laws and regulations are subject to differing interpretations and may be inconsistent among jurisdictions. These and other requirements could reduce demand for our services, require us to take on more onerous obligations in our contracts, restrict our ability to store, transfer and process data or, in some cases, impact our ability to offer our services in certain locations or our customers' ability to deploy our solutions globally. For example, ongoing legal challenges in Europe to the mechanisms allowing companies to transfer personal data from the European Economic Area to the United States could result in further limitations on the ability to transfer data across borders, particularly if governments are unable or unwilling to reach new or maintain existing agreements that support cross-border data transfers, such as the EU-U.S. and Swiss-U.S. Privacy Shield framework. The costs of compliance with, and other burdens imposed by, privacy laws, regulations and standards may limit the use and adoption of our services, reduce overall demand for our services, make it more difficult to meet expectations from or commitments to customers, lead to significant fines, penalties or liabilities for noncompliance, or slow the pace at which we close sales transactions, any of which could harm our business.

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

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

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

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

The Internet has experienced a variety of outages and other delays as a result of damages to portions of its infrastructure, denial-of-service attacks or related cyber incidents, and it could face outages and delays in the future. These outages and delays could reduce the level of Internet usage or result in fragmentation of the Internet, resulting in multiple separate Internets. These



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scenarios are not under our control and could reduce the availability of the Internet to us or our customers for delivery of our Internet-based services. Any resulting interruptions in our services or the ability of our customers to access our services could result in a loss of potential or existing customers and harm our business.

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

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

Further, in some cases, industry-specific laws, regulations or interpretive positions may also apply directly to us as a service provider. The interpretation of many of these statutes, regulations, and rulings is evolving in the courts and administrative agencies and an inability to comply may have an adverse impact on our business and results. Any failure or perceived failure by us to comply with such requirements could have an adverse impact on our business. For example, there are various statutes, regulations, and rulings relevant to the direct email marketing and text-messaging industries, including the Telephone Consumer Protection Act (TCPA) and related Federal Communication Commission (FCC) orders, which impose significant restrictions on the ability to utilize telephone calls and text messages to mobile telephone numbers as a means of communication, when the prior consent of the person being contacted has not been obtained. We are, and may in the future be, subject to one or more class-action lawsuits, as well as individual lawsuits, containing allegations that one of our businesses or customers violated the TCPA. A determination that we or our customers violated the TCPA or other communications-based statutes could expose us to significant damage awards that could, individually or in the aggregate, materially harm our business.

The market in which we participate is intensely competitive, and if we do not compete effectively, our operating results could be harmed.

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

- on-premises offerings from enterprise software application vendors;
- cloud computing application service providers, either individually or with others;
- marketing vendors, which may be specialized in advertising, targeting, messaging, or campaign automation;
- software companies that provide their product or service free of charge, and only charge a premium for advanced features and functionality;
- traditional platform development environment companies;
- cloud computing development platform companies;
- internally developed applications (by our potential customers' IT departments);

IoT platforms from large companies that have existing relationships with hardware and software companies; e-commerce solutions from emerging cloud-only vendors and established on-premises vendors; and artificial intelligence solutions from new startups and established companies.

Many of our current and potential competitors enjoy substantial competitive advantages, such as greater name recognition, longer operating histories and larger marketing budgets, as well as substantially greater financial, technical and other resources. In addition, many of our current and potential competitors have established marketing relationships and access to larger customer bases, and have major distribution agreements with consultants, system integrators and resellers. As a result, our competitors may be able to respond more quickly and effectively than we can to new or changing opportunities,

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technologies, standards or customer requirements. Furthermore, because of these advantages, even if our services are more effective than the products and services that our competitors offer, potential customers might select competitive products and services in lieu of purchasing our services. For all of these reasons, we may not be able to compete successfully against our current and future competitors.

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

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

- potential failure to achieve the expected benefits of the combination or acquisition;
- difficulties in, and the cost of, integrating operations, technologies, services, platforms and personnel;
- diversion of financial and managerial resources from existing operations;
- the potential entry into new markets in which we have little or no experience or where competitors may have stronger market positions;
- potential write-offs of acquired assets or investments, and potential financial and credit risks associated with acquired customers;
- potential loss of key employees of the acquired company;
- inability to generate sufficient revenue to offset acquisition or investment costs;
- inability to maintain relationships with customers and partners of the acquired business;
- difficulty of transitioning the acquired technology onto our existing platforms and customer acceptance of multiple platforms on a temporary or permanent basis;
- augmenting the acquired technologies and platforms to the levels that are consistent with our brand and reputation;
- increasing or maintaining the security standards for acquired technology consistent with our other services;
- potential unknown liabilities associated with the acquired businesses;
- unanticipated expenses related to acquired technology and its integration into our existing technology;
- negative impact to our results of operations because of the depreciation and amortization of amounts related to acquired intangible assets, fixed assets and deferred compensation;
- additional stock based compensation; the loss of acquired deferred revenue and unbilled deferred revenue;
- delays in customer purchases due to uncertainty related to any acquisition;
- ineffective or inadequate controls, procedures and policies at the acquired company may negatively impact our results of operations;
- challenges caused by integrating operations over distance, and across different languages and cultures;
- currency and regulatory risks associated with foreign countries and potential additional cybersecurity and compliance risks resulting from entry into new markets; and
- the tax effects of any such acquisitions.

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

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

We invest in early-to-late stage companies for strategic reasons and to support key business initiatives, and may not realize a return on our strategic investments. Many such companies generate net losses and the market for their products, services or technologies may be slow to develop, and, therefore, are dependent on the availability of later rounds of financing from banks or investors on favorable terms to continue their operations. The financial success of our investment in any company is typically dependent on a liquidity event, such as a public offering, acquisition or

other favorable market event reflecting appreciation to the cost of our initial investment. The capital markets for public offerings and acquisitions are

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dynamic and the likelihood of liquidity events for the companies we have invested in could significantly worsen. Further, valuations of privately-held companies are inherently complex due to the lack of readily available market data. If we determine that any of our investments in such companies have experienced a decline in value, we may be required to record an other-than-temporary impairment, which could be material. We have in the past written off the full value of specific investments. Similar situations could occur in the future and negatively impact our financial results. All of our investments are subject to a risk of a partial or total loss of investment capital.

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

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

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

- our ability to retain and increase sales to existing customers, attract new customers and satisfy our customers' requirements;
- the attrition rates for our services;
- the rate of expansion and productivity of our sales force;
- the length of the sales cycle for our services;
- new product and service introductions by our competitors;
- our success in selling our services to large enterprises;
- our ability to realize benefits from strategic partnerships, acquisitions or investments;
- general economic conditions, which may adversely affect either our customers' ability or willingness to purchase additional subscriptions or upgrade their services, or delay a prospective customer's purchasing decision, reduce the value of new subscription contracts, or affect attrition rates;
- variations in the revenue mix of our services and growth rates of our cloud subscription and support offerings;
- changes in our pricing policies and terms of contracts, whether initiated by us or as a result of competition;
- changes in payment terms and the timing of customer payments and payment defaults by customers;
- changes in deferred revenue and unbilled deferred revenue balances, which are not reflected in the balance sheet, due to seasonality, the compounding effects of renewals, invoice duration, size and timing, new business linearity between quarters and within a quarter and fluctuations due to foreign currency movements;
- the seasonality of our customers' businesses, especially Commerce Cloud customers, including retailers and branded manufacturers;
- changes in foreign currency exchange rates such as with respect to the British Pound;
- the amount and timing of operating costs and capital expenditures related to the operations and expansion of our business;
- the number of new employees;
- the timing of commission, bonus, and other compensation payments to employees;
- the cost, timing and management effort for the introduction of new features to our services;
  - the costs associated with acquiring new businesses and technologies and the follow-on costs of integration and consolidating the results of acquired businesses;
- expenses related to our real estate, our office leases and our data center capacity and expansion;
- timing of additional investments in our enterprise cloud computing application and platform services and in our consulting services;
- expenses related to significant, unusual or discrete events, which are recorded in the period in which the events occur;
- extraordinary expenses such as litigation or other dispute-related settlement payments;
- income tax effects;



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

- technical difficulties or interruptions in our services;

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

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

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

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

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

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

regulatory compliance costs; and

the impact of new accounting pronouncements and associated system implementations, for example, the adoption of Accounting Standards Update No. 2014-09, "Revenue from Contracts with Customers (Topic 606)" ("ASU 2014-09"), the new revenue recognition standard.

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

Additionally, if we fail to meet or exceed the expectations of securities analysts and investors, or if one or more of the securities analysts who cover us adversely change their recommendation regarding our stock, the market price of our common stock could decline. Moreover, our stock price may be based on expectations, estimates and forecasts of our future performance that may be unrealistic or that may not be met. Further, our stock price may fluctuate based on reporting by the financial media, including television, radio and press reports and blogs.

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

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

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

including our conversion to our new Lightning platform, and introduction of new services beyond the CRM market, may not be successful, and early stage interest and adoption of such new services may not result in long term success or significant revenue for us.

Additionally, if we are unable to develop enhancements to and new features for our existing or new services that keep pace with rapid technological developments, our business will be harmed. The success of enhancements, new features and services depends on several factors, including the timely completion, introduction and market acceptance of the feature, service or enhancement. Failure in this regard may significantly impair our revenue growth. In addition, because our services are



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designed to operate on a variety of network hardware and software platforms using a standard browser, we will need to continuously modify and enhance our services to keep pace with changes in Internet-related hardware, software, communication, browser and database technologies. We may not be successful in either developing these modifications and enhancements or in bringing them to market timely. Furthermore, uncertainties about the timing and nature of new network platforms or technologies, or modifications to existing platforms or technologies, could increase our research and development or service delivery expenses. Any failure of our services to operate effectively with future network platforms and technologies could reduce the demand for our services, result in customer dissatisfaction and harm our business.

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

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

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

- localization of our services, including translation into foreign languages and associated expenses;
- laws and business practices favoring local competitors;
- pressure on the creditworthiness of sovereign nations, particularly in Europe, where we have customers and a balance of our cash, cash equivalents and marketable securities;
- liquidity issues or political actions by sovereign nations, which could result in decreased values of these balances or potential difficulties protecting our foreign assets or satisfying local obligations;
- foreign currency fluctuations and controls;
- compliance with multiple, conflicting and changing governmental laws and regulations, including employment, tax, privacy, anti-corruption, import/export, antitrust, data transfer, storage and protection, and industry-specific laws and regulations, including rules related to compliance by our third-party resellers;
- regional data privacy laws and other regulatory requirements that apply to outsourced service providers and to the transmission of our customers' data across international borders;
- treatment of revenue from international sources and changes to tax codes, including being subject to foreign tax laws and being liable for paying withholding income or other taxes in foreign jurisdictions;
- different pricing environments;
- difficulties in staffing and managing foreign operations;
- different or lesser protection of our intellectual property;
- longer accounts receivable payment cycles and other collection difficulties;
- natural disasters, acts of war, terrorism, pandemics or security breaches;
- tax policies addressing multinational operations; and
- regional economic and political conditions.

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

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

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

We generally recognize revenue from customers ratably over the terms of their subscription agreements, which are typically 12 to 36 months. As a result, most of the revenue we report in each quarter is the result of subscription

agreements entered into during previous quarters. Consequently, a decline in new or renewed subscriptions in any one quarter may not be reflected in our revenue results for that quarter. Any such decline, however, will negatively affect our revenue in future quarters. Accordingly, the effect of significant downturns in sales and market acceptance of our services, and potential changes

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in our attrition rate, may not be fully reflected in our results of operations until future periods. Our subscription model also makes it difficult for us to rapidly increase our revenue through additional sales in any period, as revenue from new customers must be recognized over the applicable subscription term.

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

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

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

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

Our success depends on the willingness of third-party developers to build applications that are complementary to our services. Without the development of these applications, both current and potential customers may not find our services sufficiently attractive. In addition, for those customers who authorize a third-party technology partner access to their data, we do not provide any warranty related to the functionality, security and integrity of the data transmission or processing. Despite contract provisions to protect us, customers may look to us to support and provide warranties for the third-party applications, which may expose us to potential claims, liabilities and obligations for applications we did not develop or sell, all of which could harm our business.

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

We conduct our business in the following regions: the Americas, Europe, and Asia Pacific. The expanding global scope of our business exposes us to risk of fluctuations in foreign currency markets. This exposure is the result of selling in multiple currencies, growth in our international investments, including data center expansion, additional headcount in foreign locations, and operating in countries where the functional currency is the local currency. Specifically, our results of operations and cash flows are subject to fluctuations primarily in British Pound Sterling, Euro, Japanese Yen, Canadian Dollar and Australian Dollar against the U.S. Dollar. These exposures may change over time as business practices evolve and economic conditions change. The fluctuations of currencies in which we conduct business can both increase and decrease our overall revenue and expenses for any given fiscal period. Such volatility, even when it increases our revenues or decreases our expenses, impacts our ability to accurately predict our future results and earnings. Although we attempt to mitigate some of this volatility and related risks through foreign currency hedging, our hedging activities are limited and may not effectively offset the adverse financial impacts that may result from unfavorable movements in foreign currency exchange rates, which could adversely affect our financial condition or results of operations. Additionally, recent events, including the United Kingdom's 2016 vote in favor of exiting the European Union, or "Brexit," and similar geopolitical developments and uncertainty in the European Union and elsewhere could amplify the volatility of currency fluctuations and related risks for our business.

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

business plan.

We continue to experience significant growth in our customer base and personnel, which has placed a strain on our management, administrative, operational and financial infrastructure. We anticipate that additional investments in our internal infrastructure, data center capacity, research, customer support and development, and real estate spending will be required to scale our operations and increase productivity, to address the needs of our customers, to further develop and enhance our services, to expand into new geographic areas, and to scale with our overall growth. The additional investments we are making

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will increase our cost base, which will make it more difficult for us to offset any future revenue shortfalls by reducing expenses in the short term.

We regularly upgrade or replace our various software systems. If the implementations of these new applications are delayed, or if we encounter unforeseen problems with our new systems or in migrating away from our existing applications and systems, our operations and our ability to manage our business could be negatively impacted. Our success will depend in part upon the ability of our senior management to manage our projected growth effectively. To do so, we must continue to increase the productivity of our existing employees and to hire, train and manage new employees as needed. To manage the expected domestic and international growth of our operations and personnel, we will need to continue to improve our operational, financial and management controls, our reporting systems and procedures, and our utilization of real estate. If we fail to successfully scale our operations and increase productivity, we may be unable to execute our business plan.

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

As we target more of our sales efforts at larger enterprise customers, including governmental entities, we may face greater costs, longer sales cycles, greater competition and less predictability in completing some of our sales. In this market segment, the customer's decision to use our services may be an enterprise-wide decision and, if so, these types of sales would require us to provide greater levels of education regarding the use and benefits of our services, as well as education regarding privacy and data protection laws and regulations to prospective customers with international operations. In addition, larger customers and governmental entities may demand more configuration, integration services and features. As a result of these factors, these sales opportunities may require us to devote greater sales support and professional services resources to individual customers, driving up costs and time required to complete sales and diverting our own sales and professional services resources to a smaller number of larger transactions, while potentially requiring us to delay revenue recognition on some of these transactions until the technical or implementation requirements have been met.

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

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

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

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

The software and Internet industries are characterized by the existence of a large number of patents, trademarks and copyrights and by frequent litigation based on allegations of infringement or other violations of intellectual property rights. We have received in the past and may receive in the future communications from third parties, including practicing entities and non-practicing entities, claiming that we have infringed their intellectual property rights. In addition, we have been, and may in the future be, sued by third parties for alleged infringement of their claimed proprietary rights. Our technologies may be subject to injunction if they are found to infringe the rights of a

third-party or we may be required to pay damages, or both. Further, many of our subscription agreements require us to indemnify our customers for third-party intellectual property infringement claims, which would increase the cost to us of an adverse ruling on such a claim.

The outcome of any claims or litigation, regardless of the merits, is inherently uncertain. Any claims and lawsuits, and the disposition of such claims and lawsuits, whether through settlement or licensing discussions, or litigation, could be time-

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consuming and expensive to resolve, divert management attention from executing our business plan, result in efforts to enjoin our activities, lead to attempts on the part of other parties to pursue similar claims and, in the case of intellectual property claims, require us to change our technology, change our business practices, pay monetary damages or enter into short- or long-term royalty or licensing agreements.

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

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

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

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

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

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

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

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

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



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

In addition, we believe in the importance of our corporate culture of Ohana, which fosters dialogue, collaboration, recognition and a sense of family. As our organization grows and expands globally, and as employees' workplace expectations develop, we may find it increasingly difficult to maintain the beneficial aspects of our corporate culture. This could negatively impact our future success.

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

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

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

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

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

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

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

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

We may also be subject to additional tax liabilities due to changes in non-income based taxes resulting from changes in federal, state or international tax laws, changes in taxing jurisdictions' administrative interpretations, decisions, policies, and positions, results of tax examinations, settlements or judicial decisions, changes in accounting principles,

changes to the business operations, including acquisitions, as well as the evaluation of new information that results in a change to a tax position taken in a prior period.

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

We have a high level of debt, including the 0.25% convertible senior notes we issued in March 2013 (“0.25% Senior Notes”) due April 1, 2018, the loan we assumed when we purchased an office building located at 50 Fremont Street in San Francisco, California (“50 Fremont”), the \$500.0 million term loan to finance our acquisition of Demandware, due July 11, 2019 (the “term loan”) and capital lease arrangements. Additionally, we have significant contractual commitments in operating

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lease arrangements, which are not reflected on our consolidated balance sheets. In addition, we have a financing obligation for a leased facility of which we are deemed the owner for accounting purposes. In July 2016, we amended and restated our revolving credit facility under which we can draw down up to \$1.0 billion. Maintenance of our indebtedness and contractual commitments and any additional issuances of indebtedness could:

- impair our ability to obtain additional financing in the future for working capital, capital expenditures, acquisitions, general corporate or other purposes;
- cause us to dedicate a substantial portion of our cash flows from operations towards debt service obligations and principal repayments;
- make us more vulnerable to downturns in our business, our industry or the economy in general;
- and

due to limitations within the revolving credit facility and term loan covenants, restrict our ability to incur additional indebtedness, grant liens, merge or consolidate, dispose of assets, make investments, make acquisitions, enter into transactions with affiliates, pay dividends or make distributions, repurchase stock and enter into restrictive agreements, as defined in the credit agreement.

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

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

New lease accounting guidance will require that we record operating lease activity on our consolidated balance sheet no later than fiscal 2020, which will result in an increase in both our assets and financing obligations. The implementation of this guidance may impact our ability to obtain the necessary financing from financial institutions at commercially viable rates or at all as this new guidance will result in a higher financing obligation on our consolidated balance sheet.

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

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

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

Natural disasters or other catastrophic events may cause damage or disruption to our operations, international commerce and the global economy, and thus could have a strong negative effect on us. Our business operations are subject to interruption by natural disasters, fire, power shortages, pandemics and other events beyond our control.

Although we maintain crisis management and disaster response plans, such events could make it difficult or impossible for us to deliver our services to our customers, and could decrease demand for our services. Our corporate headquarters, and a significant portion of our research and development activities, information technology systems, and other critical business operations, are located near major seismic faults in the San Francisco Bay Area. Because we do not carry earthquake insurance for direct quake-related losses, with the exception of the building that we own in San Francisco, and significant recovery time could be required to resume operations, our financial condition and operating results could be materially adversely affected in the event of a major earthquake or catastrophic event.

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Current and future accounting pronouncements and other financial reporting standards, especially but not only concerning revenue recognition, cost capitalization and lease accounting, may negatively impact our financial results. We regularly monitor our compliance with applicable financial reporting standards and review new pronouncements and drafts thereof that are relevant to us. As a result of new standards, changes to existing standards and changes in their interpretation, we might be required to change our accounting policies, particularly concerning revenue recognition, the capitalized incremental costs to obtain a customer contract and lease accounting, to alter our operational policies and to implement new or enhance existing systems so that they reflect new or amended financial reporting standards, or to restate our published financial statements. Such changes may have an adverse effect on our reputation, business, financial position, and profit, or cause an adverse deviation from our revenue and operating profit target, which may negatively impact our financial results.

We may be subject to risks related to government contracts and related procurement regulations.

Our contracts with federal, state, local, and foreign government entities are subject to various procurement regulations and other requirements relating to their formation, administration and performance. We may be subject to audits and investigations relating to our government contracts, and any violations could result in various civil and criminal penalties and administrative sanctions, including termination of contract, refunding or suspending of payments, forfeiture of profits, payment of fines, and suspension or debarment from future government business. In addition, such contracts may provide for termination by the government at any time, without cause.

We are subject to governmental export and import controls that could impair our ability to compete in international markets and subject us to liability if we are not in full compliance with applicable laws.

Our solutions are subject to export and import controls, including the Commerce Department's Export Administration Regulations, U.S. Customs regulations and various economic and trade sanctions regulations established by the Treasury Department's Office of Foreign Assets Control. If we fail to comply with these U.S. export control laws and import laws we and certain of our employees could be subject to substantial civil or criminal penalties, including the possible loss of export or import privileges; fines, which may be imposed on us and responsible employees or managers; and, in extreme cases, the incarceration of responsible employees or managers. Obtaining the necessary authorizations, including any required license, may be time-consuming, is not guaranteed and may result in the delay or loss of sales opportunities. Furthermore, the U.S. export control laws and economic sanctions laws prohibit the shipment of certain products and services to U.S. embargoed or sanctioned countries, governments and persons. Even though we take precautions to prevent our solutions from being provisioned or provided to U.S. sanctions targets, our solutions could be provisioned to those targets or provided by our resellers despite such precautions. Any such sales could have negative consequences, including government investigations, penalties and reputational harm. Changes in our solutions or changes in export and import regulations may create delays in the introduction, sale and deployment of our solutions in international markets or prevent the export or import of our solutions to certain countries, governments or persons altogether. Any decreased use of our solutions or limitation on our ability to export or sell our solutions would likely adversely affect our business, financial condition and results of operations.

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

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

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

- variations in our operating results, earnings per share, cash flows from operating activities, deferred revenue, year-over-year growth rates for individual core service offerings and other financial metrics and non-financial metrics, and how those results compare to analyst expectations;
- variations in, and limitations of, the various financial and other metrics and modeling used by analysts in their research and reports about our business;
- forward-looking guidance to industry and financial analysts related to, for example, future revenue and earnings per share;
- changes in the estimates of our operating results or changes in recommendations by securities analysts that elect to follow our common stock;

• announcements of technological innovations, new services or service enhancements, strategic alliances or significant agreements by us or by our competitors;  
• announcements by us or by our competitors of mergers or other strategic acquisitions, or rumors of such transactions involving us or our competitors;  
• announcements of customer additions and customer cancellations or delays in customer purchases;

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recruitment or departure of key personnel;  
disruptions in our service due to computer hardware, software, network or data center problems;  
the economy as a whole, market conditions in our industry and the industries of our customers;  
trading activity by a limited number of stockholders who together beneficially own a significant portion of our outstanding common stock;  
the issuance of shares of common stock by us, whether in connection with an acquisition, a capital raising transaction or upon conversion of some or all of our outstanding convertible senior notes; and  
issuance of debt or other convertible securities.

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

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

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

We may not have the ability to pay the amount of cash due upon conversion of the notes or the fundamental change purchase price due when a holder submits its notes for purchase upon the occurrence of a fundamental change. Upon the occurrence of a fundamental change, holders of the notes may require us to purchase, for cash, all or a portion of their notes. In addition, if a holder converts its notes, we will generally pay such holder an amount of cash before delivering to such holder any shares of our common stock.

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

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

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

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



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

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

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

The hedge counterparties are financial institutions or affiliates of financial institutions, and we will be subject to the risk that these hedge counterparties may default under the convertible note hedge transactions. Our exposure to the credit risk of the hedge counterparties will not be secured by any collateral. If one or more of the hedge counterparties to one or more of our convertible note hedge transactions becomes subject to insolvency proceedings, we will become an unsecured creditor in those proceedings with a claim equal to our exposure at the time under those transactions. Our exposure will depend on many factors but, generally, the increase in our exposure will be correlated to the increase in our stock price and the volatility of our stock. In addition, upon a default by one of the hedge counterparties, we may suffer adverse tax consequences and dilution with respect to our common stock. We can provide no assurances as to the financial stability or viability of any of the hedge counterparties.

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

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

- permit the board of directors to establish the number of directors;
- provide that directors may only be removed with the approval of holders of 66 2/3 percent of our outstanding capital stock;
- require super-majority voting to amend some provisions in our amended and restated certificate of incorporation and bylaws;
- authorize the issuance of “blank check” preferred stock that our board could use to implement a stockholder rights plan (also known as a “poison pill”);
- prohibit the ability of our stockholders to call special meetings of stockholders;
- prohibit stockholder action by written consent, which requires all stockholder actions to be taken at a meeting of our stockholders;
- provide that the board of directors is expressly authorized to make, alter or repeal our bylaws; and
- establish advance notice requirements for nominations for election to our board or for proposing matters that can be acted upon by stockholders at annual stockholder meetings.

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

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

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

In connection with the acquisition of MetaMind, Inc. in April 2016, the Company issued 6,753 shares of Company common stock on May 3, 2017 and 1,661 shares of Company common stock on July 25, 2017. These issuances were made in reliance on one or more of the following exemptions or exclusions from the registration requirements of the Securities Act of 1933, as amended (the "Securities Act"): Section 4(a)(2) of the Securities Act, Regulation D promulgated under the Securities Act, and Regulation S promulgated under the Securities Act.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5. OTHER INFORMATION**

Not applicable.

**ITEM 6. EXHIBITS**

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

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SIGNATURES

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

Dated: August 25, 2017

salesforce.com, inc.

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

Dated: August 25, 2017

salesforce.com, inc.

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

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## Index to Exhibits

| Exhibit No. | Exhibit Description   | Provided Herewith | Incorporated by Reference Form SEC File No. | Exhibit | Filing Date |
|-------------|---|-------------------|---|---------|-------------|
| 3.1         | Amended and Restated Certificate of Incorporation of salesforce.com, inc.   |                   | 8-K 001-32224                               | 3.1     | 06/03/2016  |
| 3.2         | Amended and Restated Bylaws of salesforce.com, inc.   |                   | 8-K 001-32224                               | 3.2     | 03/21/2016  |
| 10.1        | Amendment to Reseller Agreement, dated May 1, 2017, between salesforce.com, inc. and Salesforce.org   | X                 |   |         |             |
| 10.2        | Amended and Restated 2013 Equity Incentive Plan   |                   | 8-K 001-32224                               | 10.1    | 06/03/2016  |
| 10.3        | Amended and Restated 2004 Employee Stock Purchase Plan  |                   | 8-K 001-32224                               | 10.2    | 06/03/2016  |
| 10.4        | Related forms of equity agreements under the Amended and Restated 2014 Inducement Equity Incentive Plan   | X                 |   |         |             |
| 10.5        | Related forms of equity agreements under the Amended and Restated 2013 Equity Incentive Plan  | X                 |   |         |             |
| 10.6        | Related forms of equity agreements under the Amended and Restated 2004 Employee Stock Purchase Plan   | X                 |   |         |             |
| 31.1        | Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a) or 15(d)-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002         | X                 |   |         |             |
| 31.2        | Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a) or 15(d)-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002         | X                 |   |         |             |
| 32.1        | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 | X                 |   |         |             |
| 101.INS     | XBRL Instance Document  |                   |   |         |             |
| 101.SCH     | XBRL Taxonomy Extension Schema Document   |                   |   |         |             |
| 101.CAL     |   |                   |   |         |             |

XBRL Taxonomy Extension Calculation Linkbase  
Document

101.DEF XBRL Extension Definition Linkbase Document

101.LAB XBRL Taxonomy Extension Label Linkbase  
Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase  
Document

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