

Cornerstone OnDemand Inc
Form 10-Q
November 03, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q
(Mark One)

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

For the quarterly period ended September 30, 2016
OR

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

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

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

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

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

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

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

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

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

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

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

ITEM 1. Condensed Consolidated Financial Statements

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

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

See accompanying notes to unaudited condensed consolidated financial statements.

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

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

See accompanying notes to unaudited condensed consolidated financial statements.

CORNERSTONE ONDEMAND, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(in thousands)

(unaudited)

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

See accompanying notes to unaudited condensed consolidated financial statements.

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

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

See accompanying notes to unaudited condensed consolidated financial statements.

CORNERSTONE ONDEMAND, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Company Overview

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

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

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

Office Locations

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

Basis of Presentation

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

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

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

Recently Adopted Accounting Pronouncement

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

Recent Accounting Pronouncements

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

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

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

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

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

2. NET LOSS PER SHARE

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

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

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

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

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

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

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3. INVESTMENTS

Investments in Marketable Securities

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

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

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

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

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

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

Strategic Investments

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

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

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

investments.

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

4. INTANGIBLE ASSETS

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

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

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

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

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

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

5. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

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

• Level 3 – Unobservable inputs.

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

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

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

Strategic Investments

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

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

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

Senior Convertible Notes

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

6. DEBT

Senior Convertible Notes

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

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

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

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

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

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

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

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

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

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

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

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

Note Hedges

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

Warrants

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

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

7. STOCK-BASED AWARDS

Stock Options

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

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

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

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

Restricted Stock Units

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

Performance-Based Restricted Stock Units

In July 2014, the Compensation Committee of the Company's Board of Directors (the "Compensation Committee") approved the issuance of performance-based restricted stock units to an executive officer of the Company. The number of shares of the Company's common stock issuable upon the vesting of this performance-based restricted stock award is based upon (a) the performance of the Company's stock price relative to a certain independent market index and (b) the recipient continuing to provide service through the end of the three year term of the award. Achievement of the maximum performance level would result in the issuance of 60,900 shares. The Company used a Monte Carlo simulation to estimate the fair value of this award which factors in the probability of the award vesting. The grant date fair value of the award was \$1.8 million, which will be recognized ratably over the three year term of the award.

In December 2014, the Compensation Committee approved the issuance of performance-based restricted stock units to certain executives of the Company. The number of shares of the Company's common stock issuable upon the vesting of these performance-based restricted stock unit awards is based upon (a) the performance of the Company's stock price relative to a certain independent market index, (b) the achievement of the Company's revenue guidance for each of fiscal year 2015 and 2016 and (c) the recipient continuing to provide services to the Company through the end of the three year term of the award. The Company finalizes its revenue guidance in February of each year, thus a grant date was established in February of 2015 and February of 2016 for each of the two tranches of the award related to that year's revenue guidance. Each tranche is treated as a separate grant and recognized from the date the revenue guidance is determined over the remaining portion of the original three year term of the award. Achievement of the maximum performance level would result in the issuance of an aggregate of 1,070,000 shares.

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

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

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

Employee Stock Purchase Plan

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

Stock-Based Compensation

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

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