Workday, Inc.
Form 10-Q
August 31, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
x 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: 001-35680

Workday, Inc.
(Exact name of registrant as specified in its charter)

Delaware	20-2480422
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

6230 Stoneridge Mall Road
Pleasanton, California 94588
(Address of principal executive offices)
Telephone Number (925) 951-9000
(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 x 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x 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	x	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. ¨

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

As of July 31, 2017, there were approximately 208 million shares of the registrant's common stock outstanding.

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Workday, Inc.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
Workday, Inc.
Condensed Consolidated Balance Sheets
(in thousands)
(unaudited)

	July 31, 2017	January 31, 2017 *As Adjusted
Assets		
Current assets:		
Cash and cash equivalents	$748,599	$539,923
Marketable securities	1,349,191	1,456,822
Trade and other receivables, net	370,557	409,780
Deferred costs	54,015	51,330
Prepaid expenses and other current assets	63,862	66,590
Total current assets	2,586,224	2,524,445
Property and equipment, net	438,754	365,877
Deferred costs, noncurrent	117,736	117,249
Acquisition-related intangible assets, net	39,110	48,787
Goodwill	158,540	158,354
Other assets	66,763	53,570
Total assets	$3,407,127	$3,268,282
Liabilities and stockholders’ equity		
Current liabilities:		
Accounts payable	$39,948	$26,824
Accrued expenses and other current liabilities	80,410	61,582
Accrued compensation	105,229	110,625
Unearned revenue	1,118,565	1,086,212
Current portion of convertible senior notes, net	332,422	—
Total current liabilities	1,676,574	1,285,243
Convertible senior notes, net	216,038	534,423
Unearned revenue, noncurrent	104,178	135,331
Other liabilities	39,940	36,677
Total liabilities	2,036,730	1,991,674
Stockholders’ equity:		
Common stock	208	202
Additional paid-in capital	2,945,596	2,681,200
Accumulated other comprehensive income (loss)	(22,197)	2,071
Accumulated deficit	(1,553,210)	(1,406,865)
Total stockholders’ equity	1,370,397	1,276,608
Total liabilities and stockholders’ equity	$3,407,127	$3,268,282

*See Note 2 for a summary of adjustments.

See Notes to Condensed Consolidated Financial Statements

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Workday, Inc.
Condensed Consolidated Statements of Operations
(in thousands, except per share data)
(unaudited)

	Three Months Ended July 31,		Six Months Ended July 31,	
	2017	2016 *As Adjusted	2017	2016 *As Adjusted
Revenues:				
Subscription services	$434,527	$306,070	$834,263	$586,238
Professional services	90,793	67,587	170,918	135,096
Total revenues	525,320	373,657	1,005,181	721,334
Costs and expenses (1):				
Costs of subscription services	65,931	51,379	125,729	100,579
Costs of professional services	92,264	66,473	169,177	125,900
Product development	221,103	161,886	417,542	303,664
Sales and marketing	171,952	134,899	327,661	262,518
General and administrative	55,699	45,705	106,901	86,888
Total costs and expenses	606,949	460,342	1,147,010	879,549
Operating loss	(81,629)	(86,685)	(141,829)	(158,215)
Other income (expense), net	938	(21,193)	(725)	(27,031)
Loss before provision for (benefit from) income taxes	(80,691)	(107,878)	(142,554)	(185,246)
Provision for (benefit from) income taxes	1,841	(65)	4,022	1,070
Net loss	$(82,532)	$(107,813)	$(146,576)	$(186,316)
Net loss per share, basic and diluted	$(0.40)	$(0.55)	$(0.71)	$(0.95)
Weighted-average shares used to compute net loss per share, basic and diluted	207,028	197,223	205,453	195,887

(1) Costs and expenses include share-based compensation expenses as follows:

Costs of subscription services	$6,580	$4,968	$12,271	$9,365
Costs of professional services	9,301	5,969	17,322	11,262
Product development	56,923	38,314	107,952	71,282
Sales and marketing	25,942	20,844	49,101	39,846
General and administrative	22,777	18,127	42,665	34,702

*See Note 2 for a summary of adjustments.

See Notes to Condensed Consolidated Financial Statements

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Workday, Inc.
Condensed Consolidated Statements of Comprehensive Loss
(in thousands)
(unaudited)

	Three Months Ended July 31,		Six Months Ended July 31,	
	2017	2016 *As Adjusted	2017	2016 *As Adjusted
Net loss	$(82,532)	$(107,813)	$(146,576)	$(186,316)
Other comprehensive income (loss), net of tax:				
Net change in foreign currency translation adjustment	1,243	(248)	966	433
Net change in unrealized gains (losses) on available-for-sale investments	146	382	(629)	934
Net change in market value of effective foreign currency forward exchange contracts	(23,396)	6,310	(24,605)	(4,754)
Other comprehensive income (loss), net of tax	(22,007)	6,444	(24,268)	(3,387)
Comprehensive loss	$(104,539)	$(101,369)	$(170,844)	$(189,703)

* See Note 2 for a summary of adjustments.

See Notes to Condensed Consolidated Financial Statements

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Workday, Inc.
Condensed Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

	Three Months Ended July 31,		Six Months Ended July 31,	
	2017	2016 *As Adjusted	2017	2016 *As Adjusted
Cash flows from operating activities				
Net loss	$(82,532)	$(107,813)	$(146,576)	$(186,316)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:				
Depreciation and amortization	34,021	26,662	67,398	52,786
Share-based compensation expenses	121,523	88,222	229,311	166,457
Amortization of deferred costs	14,009	10,917	27,646	21,356
Amortization of debt discount and issuance costs	6,785	6,690	13,735	13,289
Gain on sale of cost method investment	(526)	(65)	(526)	(65)
Impairment of cost method investment	—	15,000	—	15,000
Other	1,933	1,918	4,611	1,600
Changes in operating assets and liabilities, net of business combinations:				
Trade and other receivables, net	(71,422)	(52,337)	40,393	45,982
Deferred costs	(19,437)	(19,541)	(30,818)	(28,767)
Prepaid expenses and other assets	(8,968)	(10,070)	(12,018)	(7,682)
Accounts payable	10,778	1,542	10,213	(180)
Accrued expenses and other liabilities	(13,472)	(6,517)	(9,383)	(972)
Unearned revenue	22,434	51,914	1,162	76,851
Net cash provided by (used in) operating activities	15,126	6,522	195,148	169,339
Cash flows from investing activities				
Purchases of marketable securities	(285,197)	(557,180)	(898,448)	(1,191,136)
Maturities of marketable securities	371,471	539,315	813,341	1,164,903
Sales of available-for-sale securities	180,863	28,652	189,937	28,852
Business combinations, net of cash acquired	—	(3,670)	—	(3,670)
Owned real estate projects	(22,996)	(6,788)	(52,535)	(25,774)
Capital expenditures, excluding owned real estate projects	(38,528)	(26,539)	(69,121)	(61,017)
Purchases of cost method investments	(5,000)	(200)	(5,450)	(300)
Sale and maturities of cost method investments	732	315	732	315
Other	—	(684)	—	(296)
Net cash provided by (used in) investing activities	201,345	(26,779)	(21,544)	(88,123)
Cash flows from financing activities				
Proceeds from issuance of common stock from employee equity plans	32,274	25,395	34,527	28,776
Other	(32)	195	(76)	571
Net cash provided by (used in) financing activities	32,242	25,590	34,451	29,347
Effect of exchange rate changes	715	(144)	583	494
Net increase (decrease) in cash, cash equivalents and restricted cash	249,428	5,189	208,638	111,057
Cash, cash equivalents and restricted cash at the beginning of period	501,104	405,955	541,894	300,087
Cash, cash equivalents and restricted cash at the end of period	$750,532	$411,144	$750,532	$411,144

* See Note 2 for a summary of adjustments.

See Notes to Condensed Consolidated Financial Statements

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	Three Months Ended July 31,		Six Months Ended July 31,	
	2017	2016	2017	2016
Supplemental cash flow data				
Cash paid for interest, net of amounts capitalized	$46	$2,652	$46	$2,656
Cash paid for income taxes	1,262	3,566	2,608	4,147
Non-cash investing and financing activities:				
Vesting of early exercise stock options	$282	$460	$564	$920
Property and equipment, accrued but not paid	33,219	11,426	33,219	11,426
Non-cash additions to property and equipment	485	394	627	915

	July 31, 2017	July 31, 2016 *As Adjusted
Reconciliation of cash, cash equivalents and restricted cash as shown in the statement of cash flows		
Cash and cash equivalents	$748,599	$405,529
Restricted cash included in Other assets	1,933	1,615
Restricted cash included in Property and equipment, net	—	4,000
Total cash, cash equivalents and restricted cash	$750,532	$411,144

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Workday, Inc.
Notes to Condensed Consolidated Financial Statements
Note 1. Overview and Basis of Presentation
Company and Background
Workday provides financial management, human capital management, and analytics applications designed for the world's largest companies, educational institutions, and government agencies. We offer innovative and adaptable technology focused on the consumer internet experience and cloud delivery model. Our applications are designed for global enterprises to manage complex and dynamic operating environments. We provide our customers highly adaptable, accessible and reliable applications to manage critical business functions that enable them to optimize their financial and human capital resources. We were originally incorporated in March 2005 in Nevada and in June 2012, we reincorporated in Delaware. As used in this report, the terms "Workday," "registrant," "we," "us," and "our" mean Workday, Inc. and its subsidiaries unless the context indicates otherwise.
Basis of Presentation
The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States ("GAAP") and applicable rules and regulations of the Securities and Exchange Commission ("SEC") regarding interim financial reporting. The condensed consolidated financial statements include the results of Workday, Inc. and its wholly-owned subsidiaries. Certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. In the opinion of our management, the information contained herein reflects all adjustments necessary for a fair presentation of Workday’s results of operations, financial position and cash flows. All such adjustments are of a normal, recurring nature. The results of operations for the quarter ended July 31, 2017 shown in this report are not necessarily indicative of results to be expected for the full year ending January 31, 2018. The unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements in our Annual Report on Form 10-K for the year ended January 31, 2017, filed with the SEC on March 20, 2017.
Effective February 1, 2017, we adopted the requirements of Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers and ASU No. 2016-18, Statement of Cash Flows, Restricted Cash as discussed in Note 2. All amounts and disclosures set forth in this Form 10-Q have been updated to comply with the new standards, as indicated by the "as adjusted" footnote.
Certain prior period amounts reported in our condensed consolidated financial statements and notes thereto have been reclassified to conform to current period presentation.
Use of Estimates
The preparation of condensed consolidated financial statements in conformity with GAAP requires us to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the condensed consolidated financial statements, as well as the reported amounts of revenues and expenses during the reporting period. These estimates include, but are not limited to, the determination of the period of benefit for deferred commissions, certain assumptions used in the valuation of equity awards, and the fair value of assets acquired and liabilities assumed through business combinations. Actual results could differ from those estimates and such differences could be material to our condensed consolidated financial position and results of operations.
Segment Information
We operate in one operating segment, cloud applications. Operating segments are defined as components of an enterprise where separate financial information is evaluated regularly by the chief operating decision maker, who is our chief executive officer, in deciding how to allocate resources and assessing performance. Our chief operating decision maker allocates resources and assesses performance based upon discrete financial information at the consolidated level.

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Note 2. Accounting Standards and Significant Accounting Policies

Recently Adopted Accounting Pronouncements

ASU No. 2014-09

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU No. 2014-09, Revenue from Contracts with Customers ("Topic 606"). Topic 606 supersedes the revenue recognition requirements in Accounting Standards Codification ("ASC") Topic 605, Revenue Recognition ("Topic 605"), and requires the recognition of revenue when promised goods or services are transferred to customers in an amount that reflects the considerations to which the entity expects to be entitled to in exchange for those goods or services. Topic 606 also includes Subtopic 340-40, Other Assets and Deferred Costs - Contracts with Customers, which requires the deferral of incremental costs of obtaining a contract with a customer. Collectively, we refer to Topic 606 and Subtopic 340-40 as the "new standard." We early adopted the requirements of the new standard as of February 1, 2017, utilizing the full retrospective method of transition. Adoption of the new standard resulted in changes to our accounting policies for revenue recognition, trade and other receivables, and deferred commissions as detailed below. We applied the new standard using a practical expedient where the consideration allocated to the remaining performance obligations or an explanation of when we expect to recognize that amount as revenue for all reporting periods presented before the date of the initial application is not disclosed.

The impact of adopting the new standard on our fiscal 2017 and fiscal 2016 revenues is not material. The primary impact of adopting the new standard relates to the deferral of incremental commission costs of obtaining subscription contracts. Under Topic 605, we deferred only direct and incremental commission costs to obtain a contract and amortized those costs on a straight-line basis over the term of the related subscription contract, which was generally three years or longer. Under the new standard, we defer all incremental commission costs to obtain the contract. We amortize these costs on a straight-line basis over a period of benefit that we have determined to be five years or the related contractual renewal period, depending on whether the contract is an initial or renewal contract, respectively.

ASU No. 2016-09

In March 2016, the FASB issued ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting (Topic 718), which simplifies the accounting for share-based payment transactions, including accounting for income taxes, forfeitures, and classification in the statement of cash flows. As of February 1, 2017, we adopted the applicable provisions of ASU No. 2016-09 as follows:

- The guidance requires excess tax benefits and tax deficiencies to be recorded as income tax benefit or expense in the statement of operations when the awards vest or are settled, and eliminates the requirement to reclassify cash flows related to excess tax benefits from operating activities to financing activities on the statement of cash flows. We adopted the guidance prospectively effective February 1, 2017. Amounts previously recorded to Additional paid-in capital related to windfall tax benefits prior to February 1, 2017 remain in Stockholders' equity.
- The guidance eliminates the requirement that excess tax benefits must be realized (through a reduction in income taxes payable) before companies can recognize them. We have applied the modified retrospective transition method upon adoption. The previously unrecognized excess tax effects were recorded as a deferred tax asset in the amount of \$448.0 million, of which \$447.8 million was fully offset by a valuation allowance, and the remaining \$0.2 million resulted in a cumulative-effect adjustment to Accumulated deficit as of February 1, 2017.

ASU No. 2016-18

In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows, Restricted Cash (Topic 230), which requires that a statement of cash flows explain the change during the period for the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. The guidance is effective for our fiscal year beginning February 1, 2018. We early adopted ASU No. 2016-18 retrospectively, effective February 1, 2017. As a result of including restricted cash with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts presented on the condensed consolidated statement of cash flows, net cash flows for the three and six months ended July 31, 2016 increased by \$4 million and \$6 million, respectively.

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We adjusted our condensed consolidated financial statements from amounts previously reported due to the adoption of ASU No. 2014-09 and ASU No. 2016-18. Select condensed consolidated balance sheet line items, which reflect the adoption of the new ASU's are as follows (in thousands):

	January 31, 2017			
	As Previously Reported	Adjustments		As Adjusted
Assets				
Trade and other receivables, net	$383,908	$ 25,872	a	$409,780
Prepaid expenses and other current assets	88,336	(21,746)	a	66,590
Deferred costs	27,537	23,793	a	51,330
Deferred costs, noncurrent	43,310	73,939	a	117,249
Liabilities				
Unearned revenue	$1,097,417	$ (11,205)	a	$1,086,212
Unearned revenue, noncurrent	135,970	(639)	a	135,331

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

	Three Months Ended July 31, 2016			
	As Previously Reported	Adjustments		As Adjusted
Revenues:				
Subscription services	$306,228	$ (158)	a	$306,070
Professional services	71,495	(3,908)	a	67,587
Total revenues	377,723	(4,066)	a	373,657
Costs and expenses:				
Sales and marketing	139,177	(4,278)	a	134,899
Operating loss	(86,897)	212	a	(86,685)
Net loss	$(108,025)	$ 212	a	$(107,813)
Net loss per share, basic and diluted	$(0.55)	$ —	a	$(0.55)

	Six Months Ended July 31, 2016			
	As Previously Reported	Adjustments		As Adjusted
Revenues:				
Subscription services	$586,231	$ 7	a	$586,238
Professional services	136,922	(1,826)	a	135,096
Total revenues	723,153	(1,819)	a	721,334
Costs and expenses:				
Sales and marketing	266,668	(4,150)	a	262,518
Operating loss	(160,546)	2,331	a	(158,215)
Net loss	$(188,647)	$ 2,331	a	$(186,316)
Net loss per share, basic and diluted	$(0.96)	$ 0.01	a	$(0.95)

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Select unaudited condensed consolidated statement of cash flows line items, which reflect the adoption of the new ASUs are as follows (in thousands):

	Three Months Ended July 31, 2016			
	As Previously Reported	Adjustments		As Adjusted
Cash flows from operating activities				
Net loss	$(108,025)	$ 212	a	$(107,813)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:				
Amortization of deferred costs	6,140	4,777	a	10,917
Changes in operating assets and liabilities:				
Trade and other receivables, net	(55,992)	3,655	a	(52,337)
Deferred costs	(10,486)	(9,055)	a	(19,541)
Prepaid expenses and other assets	(11,902)	1,832	a, b	(10,070)
Unearned revenue	53,071	(1,157)	a	51,914
Net cash provided by (used in) operating activities	6,258	264	b	6,522
Change in restricted cash	(4,000)	4,000	b	—
Net cash provided by (used in) investing activities	(30,779)	4,000	b	(26,779)
Net increase (decrease) in cash and cash equivalents	925	4,264	b	5,189
Cash, cash equivalents and restricted cash at the beginning of period	404,604	1,351	b	405,955
Cash, cash equivalents and restricted cash at the end of period	$405,529	$ 5,615	b	$411,144

	Six Months Ended July 31, 2016			
	As Previously Reported	Adjustments		As Adjusted
Cash flows from operating activities				
Net loss	$(188,647)	$ 2,331	a	$(186,316)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:				
Amortization of deferred costs	12,013	9,343	a	21,356
Changes in operating assets and liabilities:				
Trade and other receivables, net	45,055	927	a	45,982
Deferred costs	(15,274)	(13,493)	a	(28,767)
Prepaid expenses and other assets	(12,678)	4,996	a, b	(7,682)
Unearned revenue	79,340	(2,489)	a	76,851
Net cash provided by (used in) operating activities	167,724	1,615	b	169,339
Change in restricted cash	(4,000)	4,000	b	—
Net cash provided by (used in) investing activities	(92,123)	4,000	b	(88,123)
Net increase (decrease) in cash and cash equivalents	105,442	5,615	b	111,057
Cash, cash equivalents and restricted cash at the end of period	$405,529	$ 5,615	b	$411,144

a Adjusted to reflect the adoption of ASU No. 2014-09, Revenue from Contracts with Customers.
b Adjusted to reflect the adoption of ASU No. 2016-18, Statement of Cash Flows, Restricted Cash.

Summary of Significant Accounting Policies

Except for the accounting policies for revenue recognition, trade and other receivables, and deferred commissions that were updated as a result of adopting ASU No. 2014-09, there have been no changes to our significant accounting policies described in the Annual Report on Form 10-K for the year ended January 31, 2017, filed with the SEC on March 20, 2017, that have had a material impact on our condensed consolidated financial statements and related notes.

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Revenue Recognition

We derive our revenues primarily from subscription services and professional services. Revenues are recognized when control of these services is transferred to our customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those services.

We determine revenue recognition through the following steps:

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

Subscription Services Revenues

Subscription services revenues primarily consist of fees that provide customers access to one or more of our cloud applications for finance, human resources, and analytics, with routine customer support. Revenue is generally recognized over time on a ratable basis over the contract term beginning on the date that our service is made available to the customer. Our subscription contracts are generally three years or longer in length, billed annually in advance, and non-cancelable.

Professional Services Revenues

Professional services revenues primarily consist of fees for deployment and optimization services, as well as training. The majority of our consulting contracts are billed on a time and materials basis and revenue is recognized over time as the services are performed. For contracts billed on a fixed price basis, revenue is recognized over time based on the proportion performed.

Contracts with Multiple Performance Obligations

Some of our contracts with customers contain multiple performance obligations. For these contracts, we account for individual performance obligations separately if they are distinct. The transaction price is allocated to the separate performance obligations on a relative standalone selling price basis. We determine the standalone selling prices based on our overall pricing objectives, taking into consideration market conditions and other factors, including the value of our contracts, the cloud applications sold, customer demographics, geographic locations, and the number and types of users within our contracts.

Trade and Other Receivables

Trade and other receivables are primarily comprised of trade receivables that are recorded at the invoice amount, net of an allowance for doubtful accounts, which is not material. Other receivables represent unbilled receivables related to subscription and professional services contracts.

Deferred Commissions

Sales commissions earned by our sales force are considered incremental and recoverable costs of obtaining a contract with a customer. Sales commissions for initial contracts are deferred and then amortized on a straight-line basis over a period of benefit that we have determined to be five years. We determined the period of benefit by taking into consideration our customer contracts, our technology and other factors. Sales commissions for renewal contracts are deferred and then amortized on a straight-line basis over the related contractual renewal period. Amortization expense is included in Sales and marketing expenses in the accompanying condensed consolidated statements of operations.

Recently Issued Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which requires the recognition of lease assets and lease liabilities on the balance sheet by lessees for those leases currently classified as operating leases under ASC Topic 840 Leases. The guidance is effective for our fiscal year beginning February 1, 2019. Early adoption is permitted. We are evaluating the accounting, transition and disclosure requirements of the standard and cannot currently estimate the financial statement impact of adoption.

In October 2016, the FASB issued ASU No. 2016-16, Intra-Entity Transfers of Assets Other Than Inventory (Topic 740), which requires entities to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. Prior to the issuance of this ASU, existing guidance prohibited the recognition of current and deferred income taxes for an intra-entity asset transfer until the asset had been sold to an outside party.

The guidance is effective for our fiscal year beginning February 1, 2018. Early adoption is permitted. We are evaluating the accounting, transition and disclosure requirements of the standard and cannot currently estimate the financial statement impact of adoption.

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In August 2017, the FASB issued ASU No. 2017-12, Derivatives and Hedging (Topic 815), which better aligns an entity's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. The guidance is effective for our fiscal year beginning February 1, 2019. Early adoption is permitted. We are evaluating the accounting, transition and disclosure requirements of the standard and cannot currently estimate the financial statement impact of adoption.

Note 3. Marketable Securities

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

	Amortized Cost	Unrealized Gains	Unrealized Losses	Aggregate Fair Value
U.S. agency obligations	$979,868	$ 2	$ (995)	$978,875
U.S. treasury securities	295,492	3	(140)	295,355
Corporate bonds	222,987	8	(227)	222,768
Commercial paper	418,897	—	—	418,897
Money market funds	81,669	—	—	81,669
	$1,998,913	$ 13	$ (1,362)	$1,997,564
Included in cash and cash equivalents	$648,374	$ —	$ (1)	$648,373
Included in marketable securities	$1,350,539	$ 13	$ (1,361)	$1,349,191

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

	Amortized Cost	Unrealized Gains	Unrealized Losses	Aggregate Fair Value
U.S. agency obligations	$908,874	$ 179	$ (535)	$908,518
U.S. treasury securities	192,028	48	(25)	192,051
Corporate bonds	290,272	42	(429)	289,885
Commercial paper	323,106	—	—	323,106
Money market funds	24,425	—	—	24,425
	$1,738,705	$ 269	$ (989)	$1,737,985
Included in cash and cash equivalents	$281,163	$ —	$ —	$281,163
Included in marketable securities	$1,457,542	$ 269	$ (989)	$1,456,822

We do not believe the unrealized losses represent other-than-temporary impairments based on our evaluation of available evidence, which includes our intent to hold these investments to maturity as of July 31, 2017. The unrealized losses on marketable securities which have been in a net loss position for 12 months or greater were not material as of July 31, 2017. We classify our marketable securities as available-for-sale at the time of purchase and reevaluate such classification as of each balance sheet date. We consider all marketable securities as available for use in current operations, including those with maturity dates beyond one year, and therefore classify these securities as current assets in the accompanying condensed consolidated balance sheets. Marketable securities on the condensed consolidated balance sheets consist of securities with original maturities at the time of purchase greater than three months and the remainder of the securities are reflected in cash and cash equivalents. We sold $181 million and $29 million of our marketable securities during the three months ended July 31, 2017 and 2016, respectively, and $190 million and $29 million of our marketable securities during the six months ended July 31, 2017 and 2016, respectively. The realized gains from the sales are immaterial.

Note 4. Fair Value Measurements

We measure our financial assets and liabilities at fair value at each reporting period using a fair value hierarchy that requires that we maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A financial instrument's classification within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Three levels of inputs may be used to measure fair value:

Level 1 — Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 — Other inputs that are directly or indirectly observable in the marketplace.

Level 3 — Unobservable inputs that are supported by little or no market activity.

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Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following table presents information about our assets and liabilities that are measured at fair value on a recurring basis and their assigned levels within the valuation hierarchy as of July 31, 2017 (in thousands):

Description	Level 1	Level 2	Level 3	Total
U.S. agency obligations	$—	$978,875	$ —	$978,875
U.S. treasury securities	295,355	—	—	295,355
Corporate bonds	—	222,768	—	222,768
Commercial paper	—	418,897	—	418,897
Money market funds	81,669	—	—	81,669
Foreign currency derivative assets	—	257	—	257
Total assets	$377,024	$1,620,797	$ —	$1,997,821
Foreign currency derivative liabilities	$—	$23,610	$ —	$23,610
Total liabilities	$—	$23,610	$ —	$23,610

The following table presents information about our assets and liabilities that are measured at fair value on a recurring basis and their assigned levels within the valuation hierarchy as of January 31, 2017 (in thousands):

Description	Level 1	Level 2	Level 3	Total
U.S. agency obligations	$—	$908,518	$ —	$908,518
U.S. treasury securities	192,051	—	—	192,051
Corporate bonds	—	289,885	—	289,885
Commercial paper	—	323,106	—	323,106
Money market funds	24,425	—	—	24,425
Foreign currency derivative assets	—	7,909	—	7,909
Total assets	$216,476	$1,529,418	$ —	$1,745,894
Foreign currency derivative liabilities	$—	$2,127	$ —	$2,127
Total liabilities	$—	$2,127	$ —	$2,127

Fair Value Measurements of Other Financial Instruments

The following table presents the carrying amounts and estimated fair values of our financial instruments that are not recorded at fair value in the condensed consolidated balance sheets (in thousands):

	July 31, 2017		January 31, 2017	
	Net Carrying Amount Before Unamortized Debt Issuance Costs	Estimated Fair Value	Net Carrying Amount Before Unamortized Debt Issuance Costs	Estimated Fair Value
0.75% Convertible senior notes	$333,768	$435,750	$325,620	$402,259
1.50% Convertible senior notes	218,030	347,513	213,180	310,470

The difference between the principal amount of the notes, $350 million for the 0.75% convertible senior notes and $250 million for the 1.50% convertible senior notes, and the net carrying amount before unamortized debt issuance costs represents the unamortized debt discount (see Note 10). The estimated fair value of the convertible senior notes, which we have classified as Level 2 financial instruments, was determined based on the quoted bid price of the convertible senior notes in an over-the-counter market on the last trading day of each reporting period.

Based on the closing price of our common stock of $102.11 on July 31, 2017, the if-converted value of the 0.75% convertible senior notes and the if-converted value of the 1.50% convertible senior notes were greater than their respective principal amounts.

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Note 5. Deferred Costs

Deferred costs, which primarily consist of deferred sales commissions, were $172 million and $169 million as of July 31, 2017 and January 31, 2017, respectively. Amortization expense for the deferred costs was $14 million and $11 million for the three months ended July 31, 2017 and 2016, respectively, and $28 million and $21 million for the six months ended July 31, 2017 and 2016, respectively. There was no impairment loss in relation to the costs capitalized for the periods presented.

Note 6. Property and Equipment, Net

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

	July 31, 2017	January 31, 2017
Land	$6,592	$6,592
Buildings	174,262	115,302
Computers, equipment and software	362,979	323,311
Computers, equipment and software acquired under capital leases	14,639	18,298
Furniture and fixtures	28,376	24,462
Leasehold improvements	118,207	108,673
Property and equipment, gross [(1)]	705,055	596,638
Less accumulated depreciation and amortization	(266,301)	(230,761)
Property and equipment, net	$438,754	$365,877

(1) Property and equipment, gross includes construction-in-progress for owned real estate projects of $147 million and $115 million that has not yet been placed in service as of July 31, 2017 and January 31, 2017, respectively.

Depreciation expense totaled $28 million and $22 million for the three months ended July 31, 2017 and 2016, respectively, and $55 million and $44 million for the six months ended July 31, 2017 and 2016, respectively. Interest costs capitalized to property and equipment totaled $2 million and $0.4 million for the three months ended July 31, 2017 and 2016, respectively, and $3 million and $0.6 million for the six months ended July 31, 2017 and 2016, respectively.

Note 7. Acquisition-related Intangible Assets, Net

Acquisition-related intangible assets, net consisted of the following (in thousands):

	July 31, 2017	January 31, 2017
Acquired developed technology	$64,900	$ 64,900
Customer relationship assets	1,000	1,000
	65,900	65,900
Less accumulated amortization	(26,790)	(17,113)
Acquisition-related intangible assets, net	$39,110	$ 48,787

Amortization expense related to acquired developed technology and customer relationship assets was $5 million and $1 million for the three months ended July 31, 2017 and 2016, respectively, and $10 million and $3 million for the six months ended July 31, 2017 and 2016, respectively.

As of July 31, 2017, our future estimated amortization expense related to acquired developed technology and customer relationship assets is as follows (in thousands):

Fiscal Period:	
2018	$9,609
2019	18,904
2020	10,281
2021	316
Total	$39,110

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Note 8. Other Assets

Other assets consisted of the following (in thousands):

	July 31, 2017	January 31, 2017
Cost method investments	$19,248	$ 14,004
Acquired land leasehold interest, net	9,623	9,676
Deposits	4,081	3,488
Net deferred tax assets	3,753	4,336
Other	30,058	22,066
Total	$66,763	$ 53,570

Our cost method investments include investments in private companies in which we do not have the ability to exert significant influence. The investments are tested for impairment at least annually, and more frequently upon the occurrence of certain events.

Note 9. Derivative Instruments

Derivative Financial Instruments

We conduct business on a global basis in multiple foreign currencies, subjecting Workday to foreign currency risk. To mitigate this risk, we utilize hedging contracts as described below. We do not enter into any derivatives for trading or speculative purposes.

Our foreign currency contracts are classified within Level 2 of the fair value hierarchy because the valuation inputs are based on quoted prices and market observable data of similar instruments in active markets, such as currency spot and forward rates.

Cash Flow Hedges

We are exposed to foreign currency fluctuations resulting from customer contracts denominated in foreign currencies. We have a hedging program in which we enter into foreign currency forward contracts related to certain customer contracts. We designate these forward contracts as cash flow hedging instruments as the accounting criteria for such designation have been met. The effective portion of the gains or losses resulting from changes in the fair value of these hedges is recorded in Accumulated other comprehensive income (loss) ("OCI") on the condensed consolidated balance sheets and will be subsequently reclassified to the related revenue line item on the condensed consolidated statements of operations in the same period that the underlying revenues are earned. The changes in value of these contracts resulting from changes in forward points are excluded from the assessment of hedge effectiveness and are recorded as incurred in Other income (expense), net on the condensed consolidated statements of operations. Cash flows from such forward contracts are classified as operating activities.

As of July 31, 2017 and January 31, 2017, we had outstanding foreign currency forward contracts designated as cash flow hedges with total notional values of $404 million and $252 million, respectively. All contracts have maturities not greater than 25 months. The notional value represents the amount that will be bought or sold upon maturity of the forward contract.

Foreign Currency Forward Contracts not Designated as Hedges

We also enter into foreign currency forward contracts to hedge a portion of our net outstanding monetary assets and liabilities. These forward contracts are not designated as hedging instruments under applicable accounting guidance, and therefore all changes in the fair value of the forward contracts are recorded in Other income (expense), net on the condensed consolidated statements of operations. These forward contracts are intended to offset the foreign currency gains or losses associated with the underlying monetary assets and liabilities. Cash flows from such forward contracts are classified as operating activities.

As of July 31, 2017 and January 31, 2017, we had outstanding forward contracts with total notional values of $55 million and $51 million, respectively.

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The fair values of outstanding derivative instruments were as follows (in thousands):

	Condensed Consolidated Balance Sheets Location	July 31, 2017	January 31, 2017
Derivative Assets:			
Foreign currency forward contracts designated as cash flow hedges	Prepaid expenses and other current assets and Other assets	$167	$ 7,149
Foreign currency forward contracts not designated as hedges	Prepaid expenses and other current assets	90	760
Derivative Liabilities:			
Foreign currency forward contracts designated as cash flow hedges	Accrued expenses and other current liabilities and Other liabilities	$21,925	$ 1,605
Foreign currency forward contracts not designated as hedges	Accrued expenses and other current liabilities	1,685	522

Gains (losses) associated with foreign currency forward contracts designated as cash flow hedges were as follows (in thousands):

	Condensed Consolidated Statement of Operations and Statement of Comprehensive Loss Locations	Three Months Ended July 31,		Six Months Ended July 31,	
		2017	2016	2017	2016
Gains (losses) recognized in OCI (effective portion) (1)	Net change in market value of effective foreign currency forward exchange contracts	$(22,923)	$6,453	$(23,898)	$(4,501)
Gains (losses) reclassified from OCI into income (effective portion)	Revenues	473	143	707	253
Gains (losses) recognized in income (amount excluded from effectiveness testing and ineffective portion)	Other income (expense), net	767	165	1,390	316

(1) Of the total effective portion of foreign currency forward contracts designated as cash flow hedges as of July 31, 2017, net losses of $2 million are expected to be reclassified out of OCI within the next 12 months.

Gains (losses) associated with foreign currency forward contracts not designated as cash flow hedges were as follows (in thousands):

Derivative Type	Condensed Consolidated Statement of Operations Location	Three Months Ended July 31,		Six Months Ended July 31,	
		2017	2016	2017	2016
Foreign currency forward contracts not designated as hedges	Other income (expense), net	$(2,619)	$1,098	$(2,625)	$(541)

We are subject to master netting agreements with certain counterparties of the foreign exchange contracts, under which we are permitted to net settle transactions of the same currency with a single net amount payable by one party to the other. It is our policy to present the derivatives gross in the condensed consolidated balance sheets. Our foreign currency forward contracts are not subject to any credit contingent features or collateral requirements and we do not believe we are subject to significant counterparty concentration risk given the short-term nature, volume, and size of the derivative contracts outstanding.

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As of July 31, 2017, information related to these offsetting arrangements was as follows (in thousands):

	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Condensed Consolidated Balance Sheets	Net Amounts of Assets Presented in the Condensed Consolidated Balance Sheets	Gross Amounts Not Offset in the Condensed Consolidated Balance Sheets		Net Assets Exposed
				Financial Instruments	Cash Collateral Received	
Derivative Assets:						