IMPERVA INC
Form 10-Q
November 05, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended September 30, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period from to

Commission File Number 001-35338

Imperva, Inc.

(Exact name of the Registrant as Specified in its Charter)

Delaware	03-0460133
(State or Other Jurisdiction of	(I.R.S. Employer
Incorporation or Organization)	Identification No.)

3400 Bridge Parkway

Redwood Shores, California 94065

(Address of Principal Executive Offices, including Zip Code)

(650) 345-9000

(Registrant's Telephone Number, including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Sections 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 every Interactive Data File required to be submitted 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 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. (Check one):

Large accelerated filer	Accelerated filer
Non-accelerated filer Emerging growth company	Smaller reporting 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

Shares of Imperva, Inc. common stock, $0.0001 par value per share, outstanding as of October 31, 2018: 35,197,514 shares.

IMPERVA, INC.

FORM 10-Q

Quarterly Period Ended September 30, 2018

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements
IMPERVA, INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(In thousands, except share and per share data)

	September 30, 2018 Unaudited	December 31, 2017 Audited
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 155,932	$ 192,538
Short-term investments	148,487	166,993
Restricted cash	30	52
Accounts receivable, net of allowance of $1,139 and $936 as of September 30, 2018 and December 31, 2017, respectively	68,261	75,535
Deferred costs, current	6,647	-
Inventory	189	617
Prepaid expenses and other current assets	9,191	14,894
Total current assets	388,737	450,629
Property and equipment, net	22,600	25,407
Goodwill	149,445	36,389
Intangible assets, net	14,376	3,184
Severance pay fund	5,799	6,554
Restricted cash	2,603	2,284
Deferred tax assets	995	2,022
Other assets including non-current deferred costs	21,388	1,593
TOTAL ASSETS	$ 605,943	$ 528,062
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 5,372	$ 5,869
Income taxes	8,916	$ 319
Accrued compensation and benefits	23,422	22,913
Accrued and other current liabilities	15,327	11,098
Deferred revenue, current	137,814	126,174
Total current liabilities	190,851	166,373
Long-term accrued severance pay	6,564	7,238
Other non-current liabilities	12,887	6,253
Deferred revenue	54,022	33,081
TOTAL LIABILITIES	264,324	212,945
Commitments and contingencies (See note 7)		
STOCKHOLDERS' EQUITY:		
Common stock, $0.0001 par value - 145,000,000 shares authorized, 35,151,159	3	3

and 34,233,888 shares issued and outstanding as of September 30, 2018 and December 31, 2017, respectively		
Additional paid-in capital	612,249	572,106
Accumulated deficit	(268,846)	(256,537)
Accumulated other comprehensive loss	(1,787)	(455)
TOTAL STOCKHOLDERS' EQUITY	341,619	315,117
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 605,943	$ 528,062

See Notes to Condensed Consolidated Financial Statements.

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IMPERVA, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Operations

(In thousands, except per share data)

(Unaudited)

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Net revenue:				
Products and license	$23,241	$26,627	$62,971	$66,217
Services	68,392	57,265	197,706	164,418
Total net revenue	91,633	83,892	260,677	230,635
Cost of revenue:				
Products and license	1,985	1,883	5,623	5,638
Services	16,997	14,684	49,634	41,455
Total cost of revenue	18,982	16,567	55,257	47,093
Gross profit	72,651	67,325	205,420	183,542
Operating expenses:				
Research and development	18,618	15,515	56,219	47,493
Sales and marketing	39,051	38,245	119,098	111,757
General and administrative	13,872	13,645	41,789	39,556
Restructuring charges	-	-	2,551	667
Amortization of intangible assets	644	133	908	582
Total operating expenses	72,185	67,538	220,565	200,055
Income (loss) from operations	466	(213)	(15,145)	(16,513)
Gain on sale of business	-	-	-	35,871
Other income, net	1,034	567	2,983	633
Income (loss) before provision for income taxes	1,500	354	(12,162)	19,991
Income tax expense	442	724	19,620	768
Net income (loss)	$1,058	$(370)	$(31,782)	$19,223
Earnings per share:				
Basic	$0.03	$(0.01)	$(0.91)	$0.57
Diluted	$0.03	$(0.01)	$(0.91)	$0.56
Shares used in computing earnings per share:				
Basic	35,066	33,907	34,782	33,590
Diluted	35,745	33,907	34,782	34,118

See Notes to Condensed Consolidated Financial Statements

IMPERVA, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Comprehensive Income (Loss)

(In thousands)

(Unaudited)

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Net income (loss)	$1,058	$(370)	$(31,782)	$19,223
Other comprehensive income (loss), net of tax:				
Net change in net unrealized gain (loss) on investments	284	55	55	105
Net change in unrealized gain (loss) on hedging instruments	891	(987)	(1,387)	1,161
Total other comprehensive (loss) income, net of tax	1,175	(932)	(1,332)	1,266
Comprehensive income (loss)	$2,233	$(1,302)	$(33,114)	$20,489

See Notes to Condensed Consolidated Financial Statements.

IMPERVA, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Stockholders’ Equity

(In thousands, except share data)

(Unaudited)

	Common Stock		Additional		Accumulated	Total
					Other	
	Shares	Amount	Paid-in Capital	Accumulated Deficit	Comprehensive Income (Loss)	Shareholders' Equity
For the nine months ended September 30, 2018						
Balance as at January 1, 2018	34,233,888	$ 3	$ 572,106	$ (256,537)	$ (455)	$ 315,117
Cumulative effect of a change in accounting principle	-	-	-	19,473	-	19,473
Issuance of common stock under employee equity plans, net of repurchases	917,271	-	10,799	-	-	10,799
Stock-based compensation	-	-	37,931	-	-	37,931
Shares withheld for tax withholding on vesting of restricted stock units	-	-	(9,151)	-	-	(9,151)
Assumed equity awards in acquisitions			564			564
Component of other comprehensive income (loss), net of tax						
Change in unrealized gain on investments	-	-	-	-	55	55
Change in unrealized loss on hedging instruments	-	-	-	-	(1,387)	(1,387)
Net loss	-	-	-	(31,782)		(31,782)
Comprehensive loss						(33,114)
Balance as at September 30, 2018	35,151,159	$ 3	$ 612,249	$ (268,846)	$ (1,787)	$ 341,619

	Common Stock		Additional		Accumulated	Total
					Other	
	Shares	Amount	Paid-in Capital	Accumulated Deficit	Comprehensive Income (Loss)	Shareholders' Equity

For the nine months ended September 30, 2017						
Balance as at January 1, 2017	33,088,990	3	510,257	(276,819)	(1,478)	231,963
Cumulative effect of a change in accounting principle			2,601	(2,587)	-	14
Issuance of common stock under employee equity plans, net of repurchases	924,350	-	17,915	-	-	17,915
Stock-based compensation	-	-	36,588	-	-	36,588
Shares withheld for tax withholding on vesting of restricted stock units	-	-	(8,217)	-	-	(8,217)
Components of other comprehensive income, net of tax						
Change in unrealized gain on investments	-	-	-	-	105	105
Change in unrealized gain on hedging instruments	-	-	-	-	1,161	1,161
Net income	-	-	-	19,223	-	19,223
Comprehensive income						20,489
Balance as at September 30, 2017	34,013,340	$ 3	$ 559,144	$ (260,183)	$ (212)	$ 298,752

See Notes to Condensed Consolidated Financial Statements.

IMPERVA, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Nine months ended September 30	
	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$(31,782)	$19,223
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	8,709	7,780
Amortization of deferred costs	3,864	-
Stock-based compensation	37,931	36,588
Amortization of acquired intangibles	908	582
Loss on disposals	-	48
Amortization of premiums/accretion of discounts on short-term investments	163	56
Gain on sale of business	-	(35,871)
Facilities exit costs	559	-
Other adjustments	668	(1,090)
Changes in operating assets and liabilities:		
Accounts receivable, net	8,741	2,767
Inventory	355	61
Deferred costs	(14,541)	-
Prepaid expenses and other assets	558	(794)
Accounts payable	(653)	(628)
Income tax payable	8,597	707
Accrued compensation and benefits	509	3,981
Accrued and other liabilities	9,033	4,229
Severance pay (net)	81	256
Deferred revenue	33,848	13,253
Deferred tax assets	1,027	(1,682)
Net cash provided by operating activities	68,575	49,466
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sales/maturities of short-term investments	71,736	66,463
Purchase of short-term investments	(53,339)	(91,878)
Proceeds from sale of business	-	35,015
Receipt of cash in escrow from sale of business	5,000	-
Net purchases of property and equipment	(5,724)	(9,835)
Acquisitions, net of cash acquired	(123,507)	-
Net cash used in investing activities	(105,834)	(235)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock, net of repurchases	10,799	14,790
Shares withheld for tax withholding on vesting of restricted stock units	(9,151)	(8,217)
Net cash provided by financing activities	1,648	6,573
Effect of exchange rate changes on cash, cash equivalents, and restricted cash	(698)	1,090

NET INCREASE (DECREASE) IN CASH, CASH EQUIVALENTS AND RESTRICTED CASH	(36,309)	56,894
CASH, CASH EQUIVALENTS AND RESTRICTED CASH - Beginning of period	194,874	109,295
CASH, CASH EQUIVALENTS AND RESTRICTED CASH - End of period	$158,565	$166,189
NONCASH INVESTING AND FINANCING ACTIVITIES:		
Property and equipment acquired but not yet paid	$1,691	$3,120

See Notes to Condensed Consolidated Financial Statements.

IMPERVA, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation and Summary of Significant Accounting Policies

Business

Imperva, Inc. (together with its subsidiaries, the "Company") was incorporated in April 2002 in Delaware. The Company is headquartered in Redwood Shores, California and has subsidiaries located throughout the world including Israel, Asia and Europe. The Company is engaged in the development, marketing, sales, service and support of cyber-security solutions that protect business-critical data and applications whether in the cloud or on-premises.

On October 10, 2018, the Company announced it entered into a definitive agreement (the "Merger Agreement") to be acquired by leading private equity technology investment firm Thoma Bravo, LLC (the "Transaction"). See Note 15 for more information.

Basis of Presentation

The Company has prepared the accompanying Condensed Consolidated Financial Statements in accordance with Article 10 of Regulation S-X and pursuant to the rules and regulations for Form 10-Q of the Securities and Exchange Commission (the "SEC"). Pursuant to those rules and regulations, the Company has condensed or omitted certain information and footnote disclosures it normally includes in its annual consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). In management's opinion, the Company has made all adjustments (consisting only of normal, recurring adjustments, except as otherwise indicated) necessary to fairly present its condensed consolidated financial position, results of operations, and cash flows. The Company's interim period operating results do not necessarily indicate the results that may be expected for any other interim period or for the full fiscal year. These condensed consolidated financial statements and accompanying notes should be read in conjunction with the consolidated financial statements and notes thereto in the Company's Annual Report on Form 10-K for the year ended December 31, 2017, which was filed with the SEC on February 23, 2018 (the "Annual Report").

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

Concentration of Revenue and Accounts Receivable

Significant customers are those which represent 10% or more of the Company's total revenue or gross accounts receivable balance at each respective balance sheet date. The Company primarily sells products and services through channel partners, including distributors and resellers, which sell to end-user customers. For the three months ended September 30, 2018, there was one channel partner that represented more than 10% of the Company's total revenue. For the nine months ended September 30, 2018, no channel partner represented more than 10% of the Company's total revenue. For the three and nine months ended September 30, 2017, there was one significant channel partner that represented more than 10% of the Company's total revenue. As of September 30, 2018, one channel partner represented 16% of the Company's total accounts receivable balance. As of December 31, 2017, one channel partner represented 18% of the Company's total accounts receivable balance.

Significant Accounting Policies

Recently Adopted Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update (ASU) 2014-09, Revenue from Contracts with Customers (Accounting Standards Codification or ASC 606). ASC 606 supersedes the revenue recognition requirements in Revenue Recognition (ASC 605), and requires the recognition of revenue as promised goods or services are transferred to customers in an amount that reflects the consideration which the entity expects to be entitled to in exchange for those goods or services. ASC 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 ASC 606 and Subtopic 340-40 as the “new standard”.

The Company adopted the new standard as of January 1, 2018, utilizing the modified retrospective method for all contracts not completed as of the date of adoption. For contracts that were modified before the effective date, the Company reflected the aggregate effect of all modifications when identifying performance obligations and allocating transaction price in accordance with practical expedient ASC 606-10-65-1-(f)-4, which did not have a material effect on the adjustment to accumulated deficit. As a result, the Company recognized the cumulative effect of initially applying the new standard as an adjustment to the opening balance of equity on January 1, 2018. The comparative information has not been adjusted and continues to be reported under ASC 605. The details of the

new policy with significant changes and quantitative impact of the changes are described in below under "Revenue from Contracts with Customers."

In May 2017, the FASB issued ASU 2017-09, "Compensation—Stock Compensation—Scope of Modification Accounting." This guidance was issued in an effort to reduce diversity in practice as it relates to applying modification accounting for changes to the terms and conditions of share-based payment awards. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017, with early adoption permitted. The Company has adopted this guidance in the first quarter of 2018. The Company noted the application of this ASU did not have any material impact on the condensed consolidated financial statements in the current period and is not expected to have material impacts in future periods as well.

The Company adopted ASU 2016-18, "Restricted Cash," and ASU 2016-15, "Classification of Certain Cash Receipts and Cash Payments." on January 1, 2018 using the modified retrospective method as of the date of adoption. ASU 2016-18 requires an entity to reconcile and explain the period over period change in total cash, cash equivalents and restricted cash within its condensed consolidated statement of cash flows and ASU 2016-15 provides guidance clarifying how certain cash receipts and cash payments should be classified. The Company adopted this accounting standard update retrospectively and, accordingly, certain line items in the condensed consolidated statement of cash flows have been reclassified to conform to the current presentation. The following table summarizes the change in cash flows as reported and as previously reported prior to the adoption of these standards (in thousands):

	Nine months ended September 30, 2018	September 30, 2017	
	As Reported	As Reported	As Previously Reported
Change in restricted cash			$ (302)
Net cash used in investing activities	(105,834)	$(235)	(537)
Net increase (decrease)	(36,309)	56,894	56,592
Balance at beginning of period*	194,874	109,295	107,343
Balance at end of period*	158,565	166,189	163,935

* Amounts in As Reported column include cash, cash equivalents and restricted cash as required. Amounts in the As Previously Reported column reflect only cash and cash equivalents.

In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business. The new standard clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. ASU 2017-01 is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, and should be applied prospectively with early adoption permitted under certain scenarios. The adoption of ASU No. 2017-01 did not have a material impact on the accompanying condensed consolidated financial statements.

Recently Issued Accounting Pronouncements

In February 2018 the FASB issued ASU 2018-02, Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, that gives entities the option

to reclassify to retained earnings tax effects related to items that have been stranded in accumulated other comprehensive income as a result of the Tax Cuts and Jobs Act (the Act). An entity that elects to reclassify these amounts must reclassify stranded tax effects related to the Act’s change in U.S. federal tax rate for all items accounted for in other comprehensive income. These entities can also elect to reclassify other stranded effects that relate to the Act but do not directly relate to the change in the federal rate. Entities can choose whether to apply the amendments retrospectively to each period in which the effect of the Act is recognized or to apply the amendments in the period of adoption. The standard is effective for the Company on January 1, 2019, with early adoption permitted. The Company is evaluating the impact of adopting this new accounting guidance on its condensed consolidated financial statements.

In August 2017, FASB issued ASU 2017-12 Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. Under the new guidance, more hedging strategies will be eligible for hedge accounting and the application of hedge accounting is simplified. The new guidance amends presentation and disclosure requirements, and how effectiveness is assessed. The standard is effective for the Company on January 1, 2019, with early adoption permitted. The Company is evaluating the impact of adopting this new accounting guidance on its condensed consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Simplifying the Test for Goodwill Impairment (Topic 350), which simplifies the measurement of goodwill impairment by removing the second step of the goodwill impairment test, which requires the determination of the fair value of individual assets and liabilities of a reporting unit. Under this guidance, goodwill impairment is to be measured as the amount by which a reporting unit’s carrying value exceeds its fair value with the loss recognized not to exceed the total amount of goodwill allocated to the reporting unit. The guidance is effective beginning January 1, 2020 on a prospective basis, with early adoption permitted for interim or annual goodwill impairment tests performed after January 1, 2017. The standard is to be

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applied on a prospective basis. The Company does not anticipate a material impact to the condensed consolidated financial statements once implemented.

In June 2016, the FASB Issued ASU 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The new standard requires financial assets measured at amortized cost be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The standard will be effective for the Company beginning January 1, 2020, with early application permitted. The Company is evaluating the impact of adopting this new accounting guidance on its condensed consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02 regarding ASC 842 Leases. The amendments in this guidance require balance sheet recognition of lease assets and lease liabilities by lessees for leases classified as operating leases, with an optional policy election to not recognize lease assets and lease liabilities for leases with a term of 12 months or less. The amendments also require new disclosures, including qualitative and quantitative requirements, providing additional information about the amounts recorded in the financial statements. The standard will be effective for the Company beginning January 1, 2019. The amendments require a modified retrospective approach with optional practical expedients. In July 2018, the FASB issued ASU 2018-11, Leases (Topic 842): Targeted Improvements. ASU 2018-11 provides entities another option for transition, allowing entities to not apply the new standard in the comparative periods they present in their financial statements in the year of adoption. While the Company continues to evaluate the effect of the standard on its ongoing financial reporting, the Company currently believes that the adoption of the ASU may materially affect its Balance Sheet.

Change in Accounting Estimate

In Q3 2018, the Company reviewed the estimated useful lives of its certain property and equipment. This review indicated that the actual lives of certain equipment were longer than the estimated useful lives used for depreciation purposes in the Company's financial statements. As a result, effective in August 2018, the Company changed its estimates of the useful lives of the relevant equipment to better reflect the estimated periods during which these assets will remain in service. The estimated useful lives of the relevant equipment were increased from 3 years to 5 years. The effect of this change in accounting estimate was to reduce depreciation expense by $0.7 million, increase net income by $0.7 million, and increase basic and diluted earnings per share by $0.02 for the three months ended September 30, 2018. The Company also evaluated the impact of the change in future depreciation and estimated that this change in accounting estimate will result in decreases of depreciation expenses of $1.7 million and $2.6 million for the years ended December 31, 2018 and 2019, respectively.

Revenue from Contracts with Customers

The reported results for three and nine month period ended September 30, 2018 reflect the application of the new revenue standard while the reported results for three and nine months period ended September 30, 2017 were prepared under the guidance of ASC 605, which is also referred to herein as "legacy GAAP" or the "previous guidance". The adoption of the new revenue standard represents a change in accounting principle with the intent to align revenue recognition with the delivery of products and services and provide financial statement readers with enhanced disclosures. In accordance with the new revenue standard, revenue is recognized when a customer obtains control of promised products and services. The amount of revenue recognized reflects the consideration to which the Company expects to be entitled to receive in exchange for these products and services. To achieve this core principle, the Company applies the following five steps:

1) Identify the contract with a customer

A contract with a customer exists when (i) the Company enters into an enforceable contract with a customer that defines each party's rights regarding the products and services to be transferred and identifies the payment terms related to these products and services, (ii) the contract has commercial substance and, (iii) the Company determines that collection of substantially all consideration for products and services that are transferred is probable based on the customer's intent and ability to pay the promised consideration. The Company applies judgment in determining the customer's ability and intention to pay, which is based on a variety of factors including the customer's historical payment experience or, in the case of a new customer, published credit and financial information pertaining to the customer.

2) Identify the performance obligations in the contract

Performance obligations promised in a contract are identified based on the products and services that will be transferred to the customer that are both capable of being distinct, whereby the customer can benefit from the products and services either on its own or together with other resources that are readily available from third parties or from the Company, and are distinct in the context of the contract, whereby the transfer of the products and services is separately identifiable from other promises in the contract. To the extent a contract includes multiple promised products and services, the Company must apply judgment to determine whether promised products and services are capable of being distinct and distinct in the context of the contract. If these criteria are not met the promised products and services are accounted for as a combined performance obligation.

3) Determine the transaction price

The transaction price is determined based on the consideration to which the Company will be entitled in exchange for transferring products and services to the customer. None of the Company's contracts contained a significant financing component. Determining the transaction price requires significant judgment, which is discussed by revenue category in further detail below.

4) Allocate the transaction price to performance obligations in the contract

If the contract contains a single performance obligation, the entire transaction price is allocated to the single performance obligation. Contracts that contain multiple performance obligations require an allocation of the transaction price to each performance obligation based on a relative standalone selling price basis. The Company determines standalone selling price based on the price at which the performance obligation is sold separately. If the standalone selling price is not observable through past standalone transactions, the Company estimates the standalone selling price taking into account available information such as past transactions, market conditions and internally approved pricing guidelines related to the performance obligations.

5) Recognize revenue when or as the Company satisfies a performance obligation

The Company satisfies performance obligations either over time or at a point in time as discussed in further detail below. Revenue is recognized at the time the related performance obligation is satisfied by transferring promised products and services to a customer.

Revenue Recognition

The Company derives revenue from two sources: (i) products and license revenue, which includes hardware and on-premise software license revenue and (ii) services revenue, which includes subscription arrangements, maintenance and support, professional services and training. Licenses for on-premises software are either perpetual or term licenses and provide the customer with a right to use the software. Substantially all of the Company’s products and license sales have been sold in combination with maintenance and support services.

At contract inception, the Company assesses the products and services promised in its contracts with customers and identifies a performance obligation for each promise to transfer to the customer a product or service (or bundle of products or services) that is distinct – i.e., if a product or service is separately identifiable from other items in the bundled package and if a customer can benefit from it on its own or with other resources that are readily available to the customer. The Company recognizes revenue when or as it satisfies a performance obligation by transferring control of a product or service to a customer.

In rare situations, the Company may agree to accept a lower consideration than the contractual price. The Company accounts for such situations as variable consideration and estimate future price reductions based on the Company’s historical experience. The impact of such price reductions on the Company’s revenue for the three and nine month period ended September 30, 2018 was not significant.

Once the Company has determined the transaction price, the total transaction price is allocated to each performance obligation in a manner depicting the amount of consideration to which the Company expects to be entitled in exchange for transferring the good(s) or service(s) to the customer (the “allocation objective”). If the allocation objective is met at contractual prices, no further allocations are made. Otherwise, the Company allocates the transaction price to each performance obligation identified in the contract on a relative standalone selling price basis.

In order to determine the standalone selling price of its promised goods or services, the Company conducts a regular analysis to determine whether its goods or services have an observable standalone selling price. In determining observable standalone selling price, the Company requires that a substantial majority of the standalone selling prices for a good or service fall within a reasonably narrow pricing range. If the Company does not have a directly observable standalone selling price for a particular goods or service, then the Company estimates a standalone selling

price by reviewing external and internal market factors including, but not limited to, pricing practices including historical discounting, major service groups, and the geographies in which the Company offers its products and services. The determination of standalone selling price is made through consultation with and approval by the Company’s management. Selling prices are analyzed on a quarterly basis to identify if the Company has experienced significant changes in its selling prices.

The upfront payment pattern relative to the delivery of subscription, maintenance and services and associated revenue recognition generates significant deferred revenue. The Company refers to contract liabilities as “deferred revenue” on the condensed consolidated financial statements and related disclosures.

The revenue and revenue recognition policies for the different types of revenue are described below:

Products and License Revenue

Products and license revenue consists of hardware and on-premise software license sales. Hardware revenue is recognized at a point in time upon delivery.

The Company's on-premise software licenses sold without hardware generally have significant stand-alone functionality to the customer upon delivery and are considered functional intellectual property ("IP"). Revenue allocated to on-premise software licenses is typically recognized at a point in time upon delivery of the license.

Services Revenue

Services revenue consists of subscription arrangements, maintenance and support, professional services, and training. Subscription services are offered under renewable, fee-based contracts, which provide access to the Incapsula service and certain functionality within SecureSphere platform. Payments for subscription services are typically due monthly/quarterly/annually in advance. Subscription services are viewed as a stand-ready performance obligation that is satisfied over time and typically have a term of one to three years. Unearned subscription revenue is included in deferred revenue.

Maintenance and support arrangements are offered under renewable, fee-based contracts, which include technical support, hardware repair and replacement parts, bug fixes, patches and unspecified upgrades on a when-and-if-available basis. Payments for maintenance and support are typically due annually in advance. Maintenance and support services are viewed as a stand-ready performance obligation that is satisfied over time and typically have a term of one to three years. Unearned maintenance and support revenue is included in deferred revenue.

Professional services revenue consists of fees related to implementation and consulting services. The Company's professional services typically are considered distinct from the related software or subscription services as the promise to transfer the software or subscription can be fulfilled independently from the promise to deliver the implementation and consulting services (i.e., customer receives standalone functionality from the license or subscription and the customer obtains the intended benefit of the license or subscription without the professional services). Professional services revenue is typically recognized over time as the services are rendered, using an efforts-expended (labor hours) input method. Professional service arrangements are typically short term in nature and are largely completed within 90 days from the start of service.

Training services revenue consists of fees related to training customers and partners on the use of its products. Training services are distinct performance obligations recognized upon delivery of the training.

Taxes collected from customers and remitted to governmental authorities are not included in revenue. Shipping and handling costs associated with outbound freight are accounted for as a fulfillment cost and are included in cost of revenues.

Deferred Costs

The Company capitalizes contract origination costs that are incremental and recoverable costs of obtaining a contract with a customer. These costs are deferred and amortized over a benefit period of 5 years. The Company determined the period of benefit by taking into consideration of customer contracts, the Company's technology and other factors. The Company applies the practical expedient to expense costs as incurred if the expected benefit period was 1 year or less. This applies to sales commissions for renewal of annual contracts which would be deferred and then amortized over the related contractual renewal period. Amortization expense is included in sales and marketing expenses in the accompanying condensed consolidated statements of operations.

Allocating the Transaction Price to Performance Obligations

For certain arrangements with multiple deliverables, the Company previously allocated the arrangement fee to the non-software element based upon the relative selling price of such element and, if software and software-related elements (e.g., maintenance and support for the software element) were also included in the arrangement, the Company allocated the arrangement fee to each of those software and software-related elements as a group. After such allocations were made, the amount of the arrangement fee allocated to the software and software-related elements was accounted for using the residual method. Under the new standard, the total transaction price is allocated to each performance obligation on a relative standalone selling price basis, irrespective of whether the performance obligations would have been previously categorized as software or non-software elements.

Deferred Revenue and Contingent Revenue

The Company previously limited the amount of revenue recognized for delivered elements to the amount that was not contingent on the future delivery of products or services, or subject to the Company's future performance obligation. Under the new standard, there is no requirement to limit the allocated transaction price to non-contingent amounts.

There have been no other material changes to the Company's significant accounting policies as compared to the significant accounting policies described in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

Adoption Date Impact

The following tables summarize the impacts of adopting the new standard on the Company's condensed consolidated financial statements as of adoption on January 1, 2018. Select condensed consolidated balance sheet line items that reflect the adoption of the new standard are as follows (in thousands):

	As reported on December 31, 2017	Impact of adoption	As adjusted on January 1, 2018
ASSETS			
Deferred costs, current	-	$3,755	$3,755
Other assets including non-current deferred costs	1,593	12,156	13,749
LIABILITIES			
Deferred revenue, current	126,174	(4,159)	122,015
Deferred revenue	33,081	597	33,678
STOCKHOLDERS' EQUITY			
Accumulated deficit	$ (256,537)	$19,473	$(237,064)

The deferred cost balance as of January 1, 2018 represents the incremental cost to obtain contracts which were not complete as of the adoption date, that were expensed pursuant to the previous accounting policy, but require capitalization under the new standard.

The deferred revenue balance decreased as of January 1, 2018 primarily due to impacts from application of revised standalone selling price methodologies, and due to certain hybrid pricing models, more specifically our FlexProtect hybrid licensing program, which was delivered prior to January 1, 2018. Under the previous guidance the entire transaction fee was recognized ratably, however, the new standard requires upfront recognition of a portion of the transaction price allocated to the functional license delivered at the inception of the arrangement.

Current Period Impact

The following tables summarize the impacts of adopting the new standard on the Company's condensed consolidated financial statements for the nine months ended September 30, 2018. Select consolidated balance sheet line items that reflect the adoption of the new standard are as follows (in thousands):

	As of September 30, 2018		
	As reported	Adjustments	Balances without adoption of Topic 606
ASSETS			
Deferred cost, current	$6,647	$ (6,647)	-
Other assets including non-current deferred costs	21,388	(19,941)	1,447
LIABILITIES AND STOCKHOLDERS' EQUITY			
Deferred revenue, current	137,814	13,781	151,595
Deferred revenue	54,022	(1,372)	52,650
STOCKHOLDERS' EQUITY			
Accumulated deficit	$(268,846)	$ (38,997)	$(307,843)

Select Condensed Consolidated Statement of operations line items for the three and nine months ended September 30, 2018 that reflect the adoption of the new standard are as follows (in thousands):

	Three months ended September 30, 2018			Nine months ended September 30, 2018		
	As reported	Adjustments	Balances without adoption of Topic 606	As reported	Adjustments	Balances without adoption of Topic 606
Net revenue:						
Products and license	$23,241	$ (3,377)	$ 19,864	$62,971	$ (6,387)	$ 56,584
Services:						
Subscriptions	38,519	(378)	38,141	109,957	(352)	109,605
Maintenance and Support	25,220	(967)	24,253	75,393	(2,365)	73,028
Professional services and training	4,653	71	4,724	12,356	257	12,613
Total services	68,392	(1,274)	67,118	197,706	(2,460)	195,246
Total net revenue	91,633	(4,651)	86,982	260,677	(8,847)	251,830
Operating expenses:						
Sales and marketing	39,051	2,882	41,933	119,098	10,677	129,775
Income (loss) from operations	466	(7,533)	(7,067)	(15,145)	(19,524)	(34,669)
Net income (loss)	1,058	(7,533)	(6,475)	(31,782)	(19,524)	(51,306)
Net loss per share of common stock stockholders, basic and diluted	$0.03		$ (0.18)	$(0.91)		$ (1.48)

Select Condensed Consolidated Statement of Cash Flows for the nine months ended September 30, 2018 that reflect the adoption of the new standard are as follows (in thousands):

	Nine months ended September 30, 2018		
Statement of Cash Flows	As reported	Adjustments	Balance without adoption of Topic 606
Net loss	$(31,782)	$ (19,524)	$(51,306)
Adjustments to reconcile net income (loss) to net cash provided by operating activities			

Amortization of deferred costs	3,864	(3,864)	-
Changes in operating assets and liabilities:			
Deferred costs	(14,541)	14,541	-
Deferred revenue	33,848	8,847	42,695
Net cash provided by operating activities	$68,575		$68,575

Disaggregation of Revenue

The Company's revenue was comprised of the following major product and service lines (in thousands):

	Three months ended September 30		Nine months ended September 30	
	2018	2017	2018	2017
Major product/service lines				
Products and licenses	$23,241	$26,627	$62,971	$66,217
Services:				
Subscriptions	38,519	30,956	109,957	86,305
Maintenance and support	25,220	23,133	75,393	67,709
Professional services and training	4,653	3,176	12,356	10,404
	68,392	57,265	197,706	164,418
Total revenue	$91,633	$83,892	$260,677	$230,635

The Company's revenue by geographic region is based on the customer's location and presented under footnote 11.

The following table presents the Company's revenue by timing of revenue recognition (in thousands):

	Three months ended September 30		Nine months ended September 30	
	2018	2017	2018	2017
Timing of revenue recognition				
Products and services transferred at a point in time	$23,241	$26,627	$62,971	$66,217
Products and services transferred over time	68,392	57,265	197,706	164,418
Total revenue	$91,633	$83,892	$260,677	$230,635

Deferred Revenue

The following table provides information about deferred revenues from contracts with customers (in thousands).

	As of September 30, 2018
Deferred revenue (current)	$ 137,814
Deferred revenue	54,022
Total deferred revenue	$ 191,836

The deferred revenue balance includes customer deposits of $3.2 million, primarily related to cancellable services and subscriptions which were billed in advance.

Standard payment terms to customers range from 30 to 90 days; however, payment terms and conditions in the Company's customer contracts may vary. In some cases, customers prepay for products and services in advance of our delivery of the related products or services; in other cases, payment is due as services are performed or in arrears following the delivery of the related products or services. Unbilled revenues primarily relate to the Company's rights to consideration for work completed but not billed at the reporting date and typically relate to professional services. The unbilled revenues are transferred to receivables when the rights become unconditional. Deferred revenue relates to the advance consideration received from customers, which precedes our performance to satisfy the associated performance obligation(s). The Company's deferred revenue primarily result from customer payments received upfront for subscription, maintenance and support on software licenses and certain fixed fee professional services because these performance obligations are satisfied over time.

$50.8 million and $110.0 million of services revenue was recognized during the three and nine months ended September 30, 2018 respectively, that was included in the deferred revenue balances at the beginning of the period.

Transaction Price Allocated to the Remaining Performance Obligations

The following table includes estimated revenue expected to be recognized over time related to performance obligations that are unsatisfied (or partially unsatisfied) as of September 30, 2018 (in thousands).

	Remainder of 2018	2019	2020	2021	Thereafter
Performance obligations transferred over time	$ 53,896	$94,348	$30,387	$11,458	$ 1,747
Total net revenue	$ 53,896	$94,348	$30,387	$11,458	$ 1,747

Amortization of Deferred Costs

Deferred costs primarily consist of capitalized incremental contract origination costs and were $26.6 million and $15.9 million as of September 30, 2018 and January 1, 2018 respectively. Amortization costs of $1.6 million and $3.9 million were recorded for the three and nine months ended September 30, 2018, respectively, and there were no impairments of deferred costs during either period.

2. Cash, Cash Equivalents, Restricted Cash and Short-Term Investments

The following table provides a summary of cash, cash equivalents, and restricted cash reported within the Condensed Consolidated Balance Sheets that reconciles to the corresponding amount in the Condensed Consolidated Statements of Cash Flows (in thousands):

	As of September 30, 2018	As of December 31, 2017	As of September 30, 2017	As of December 31, 2016
Cash and cash equivalents	$ 155,932	$ 192,538	$ 163,935	$ 107,343
Restricted cash included in Current assets	30	52	51	68
Restricted cash included in Non-current assets	2,603	2,284	2,203	1,884
Total cash, cash equivalents, and restricted cash shown in the Statements of Cash Flows	$ 158,565	$ 194,874	$ 166,189	$ 109,295

The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Cash and cash equivalents consist of cash on hand, highly liquid investments in commercial paper, money market funds, corporate debt obligations and various deposit accounts. Restricted cash represents bank deposits to secure bank guarantees provided to its lessors for its operating lease arrangements.

The Company considers all high-quality investments purchased with original maturities at the date of purchase greater than three months to be short-term investments. Investments are available to be used for current operations and are, therefore, classified as current assets even though maturities may extend beyond one year. Cash equivalents and short-term investments are classified as available-for-sale and are, therefore, recorded at fair value on the condensed consolidated balance sheets, with any unrealized gains and losses reported in accumulated other comprehensive income (loss), which is reflected as a separate component of stockholders’ equity in its condensed consolidated balance sheets, until realized. The Company uses the specific-identification method to compute gains and losses on the investments. The amortized cost of securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization and accretion is included as a component of other income, net in the condensed consolidated statements of operations.

Cash, cash equivalents and short-term investments consist of the following (in thousands):

	As of September 30, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash and cash equivalents:				
Cash	$ 101,873	-	-	$ 101,873
Money market funds	54,059	-	-	54,059
U.S. government and U.S. government agencies	-	-	-	-
Total	$ 155,932	$ -	$ -	$ 155,932

Short-term investments:				
Commercial paper	-	-	-	-
Corporate debt obligations	106,651	2	395	106,258
U.S. government and U.S. government agencies	42,147	-	158	41,989
Certificate of deposits	240	-	-	240
Total	$149,038	$ 2	$ 553	$148,487

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	As of December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash and cash equivalents:				
Cash	$92,030	-	-	$92,030
Money market funds	84,144	-	-	84,144
U.S. government and U.S. government agencies	16,367	-	3	16,364
Total	$192,541	-	$ 3	$192,538
Short-term investments:				
Commercial paper	$699	-	-	$699
Corporate debt obligations	123,320	-	488	122,832
U.S. government and U.S. government agencies	43,097	-	114	42,983
Certificate of deposits	480	-	1	479
Total	$167,596	-	$ 603	$166,993

The following table summarizes the cost and estimated fair value of short-term investments based on stated effective maturities as of September 30, 2018 (in thousands):

	As of September 30, 2018	
	Amortized Cost	Estimated Fair Value
Short-term investments:		
Due within one year	$112,157	$111,731
Due within two years	36,881	36,756
Total	$149,038	$148,487

The gross unrealized loss related to these securities was due primarily to changes in interest rates. The Company reviews its short-term investments on a regular basis to evaluate whether or not any security has experienced an other-than-temporary decline in fair value. The Company considers factors such as the length of time and extent to which the market value has been less than the cost, the financial condition and near-term prospects of the issuer and its intent to sell, or whether it is more likely than not the Company will be required to sell the investment before recovery of the investment's amortized cost basis. If the Company believes that an other-than-temporary decline exists in one of these securities, the Company will write down these investments to fair value. For debt securities, the portion of the write-down related to credit loss would be recorded to other income, net, in the Company's condensed consolidated statements of operations. Any portion not related to credit loss would be recorded to accumulated other comprehensive income (loss), which is reflected as a separate component of stockholders' equity in the Company's condensed consolidated balance sheets. During the three and nine months ended September 30, 2018 and 2017, the Company did not consider any of its investments to be other-than-temporarily impaired.

The following tables show the short-term investments in an unrealized loss position and the related gross unrealized losses and fair value and length of time that the short-term investments have been in a continuous unrealized loss position (in thousands):

	As of September 30, 2018					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Commercial paper	$-	$ -	$-	$ -	$-	$ -
Corporate debt obligations	41,832	191	56,755	204	98,587	395
U.S. government and U.S. government agencies	41,388	158	-	-	41,388	158
Certificate of deposits	-	-	240	-	240	-
	$83,220	$ 349	$56,995	$ 204	$140,215	$ 553

	As of December 31, 2017					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Commercial paper	$699	$ -	$-	$ -	$699	$ -
Corporate debt obligations	77,715	377	45,117	111	122,832	488
U.S. government and U.S. government agencies	29,093	76	11,461	38	40,554	114
Certificate of deposits	-	-	479	1	479	1
	$107,507	$ 453	$57,057	$ 150	$164,564	$ 603

3. Fair Value of Financial Instruments

The Company evaluates assets and liabilities subject to fair value measurements on a recurring basis to determine the appropriate level to classify them for each reporting period. There have been no transfers between fair value measurement levels during the three and nine months ended September 30, 2018.

The Company’s cash equivalents and short-term investment instruments are classified within Level I or Level II of the fair value hierarchy because they are valued using quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency. The types of instruments valued based on quoted market prices in active markets include mutual funds and money market securities, and are generally classified within Level I of the fair value hierarchy. The types of instruments valued based on quoted prices in less active markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability include U.S. agency securities, investment-grade corporate bonds, bank deposits, and commercial paper. Such instruments are generally classified within Level II of the fair value hierarchy.

The Company executes its foreign currency contracts primarily in the retail market in an over-the-counter environment with a relatively high level of price transparency. The market participants usually are large multi-national and regional banks. The Company’s foreign currency contracts valuation inputs are based on quoted prices and quoted pricing intervals from public data sources and do not involve management judgment. These contracts are typically classified within Level II of the fair value hierarchy.

The following table sets forth the Company’s assets and liabilities that were measured at fair value as of September 30, 2018 and December 31, 2017, by level within the fair value hierarchy (in thousands):

	As of September 30, 2018			
	Level I	Level II	Level III	Fair Value
Financial Assets:				
Cash equivalents:				
Money market funds	$54,059	-	-	$ 54,059
Short-term investments:				

Commercial paper	-	-	-	-
Corporate debt obligations	-	106,258	-	106,258
U.S. government and U.S. government agencies	-	41,989	-	41,989
Certificate of deposits	-	240	-	240
Total financial assets	$54,059	$148,487	-	$ 202,546
Financial Liability:				
Accrued and other current liabilities - Forward foreign exchange contracts	$-	$585	-	$ 585

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	As of December 31, 2017			
	Level I	Level II	Level III	Fair Value
Financial Assets:				
Cash equivalents:				
Money market funds	$84,144	$-	$ -	$84,144
U.S. government and U.S. government agencies		16,364		16,364
Short-term investments:				
Commercial paper	-	699	-	699
Corporate debt obligations	-	122,832	-	122,832
US government and US government agencies	-	42,983	-	42,983
Certificate of deposits	-	479	-	479
Prepaid expenses and other current assets - Forward foreign exchange contracts	-	551	-	551
Total financial assets	$84,144	$183,908	$ -	$268,052

In addition to the amounts disclosed in the above table, the fair value of the Company's Israeli severance pay assets, totaling $5.8 million and $6.6 million as of September 30, 2018 and December 31, 2017, respectively comprised of Level II assets.

4. Derivative Instruments

The Company's primary objective for holding derivative instruments is to reduce its exposure to foreign currency rate changes. The Company reduces its exposure by entering into forward foreign exchange contracts with respect to operating expenses that are forecast to be incurred in currencies other than U.S. dollars. Substantially all of the Company's revenue and capital purchasing activities and a majority of its operating expenditures are transacted in U.S. dollars. However, certain operating expenditures are incurred in or exposed to other currencies, primarily the Israeli shekel, the British pound and the Euro.

The Company has established forecasted transaction currency risk management programs to protect against fluctuations in fair value and the volatility of future cash flows caused by changes in exchange rates. The Company's currency risk management program includes forward foreign exchange contracts designated as cash flow hedges. These forward foreign exchange contracts generally mature within 12 months. The Company does not enter into derivative financial instruments for trading purposes.

Derivative instruments measured at fair value and their classification on the condensed consolidated balance sheets are presented in the following tables (in thousands):

	As of September 30, 2018		As of December 31, 2017	
	Notional	Fair Value	Notional	Fair Value

	Amount		Amount	
Foreign exchange forward contract derivatives in cash flow hedging relationships - included in (accrued and other current liabilities)	$ 12,059	$ (585)	$ -	$ -
Foreign exchange forward contract derivatives in cash flow hedging relationships - included in prepaid expenses and other current assets	$ -	$ -	$ 66,560	$ 551

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Gains (losses) on derivative instruments and their classification on the condensed consolidated statement of operations are presented in the following table (in thousands):

	For the three months ended September 30		For the nine months ended September 30	
	2018	2017	2018	2017
Foreign exchange forward contract derivatives in cash flow hedging relationships:				
Gains recognized in OCI (a)	$114	$90	$470	$4,422
Losses recognized in OCI (a)	(48)	(513)	(2,762)	(530)
Gains recognized from accumulated OCI into net income (b)	$-	$1,115	$317	$2,103
Losses recognized from accumulated OCI into net income (b)	$(825)	$-	$(1,222)	$(10)

(a) Net change in the fair value of the effective portion classified in other comprehensive income (loss) ("OCI").

(b) Effective portion of cash flow hedges reclassified from accumulated other comprehensive income (loss) into earnings, of which $155 and $670 were recognized within cost of sales and operating expenses, respectively, for the three months ended September 30, 2018; $144 of losses and $761 of losses, were recognized within cost of sales and operating expenses, respectively, for the nine months ended September 30, 2018; $199 and $916 were recognized within cost of sales and operating expenses, respectively, for the three months ended September 30, 2017 and $267 and $1,826 were recognized within cost of sales and operating expenses, respectively, for the nine months ended September 30, 2017. All amounts are reflected within the respective condensed consolidated statement of operations.

5. Business Combinations

On August 9, 2018, the Company completed the acquisition of Prevoty, Inc ("Prevoty"), a private software security company based in Los Angeles, California that provides Runtime Application Self-Protection, or security tools that function within actual software applications. Imperva's condensed consolidated statements of operations include the operating results of the Prevoty business from the date of acquisition.

The Company has accounted for this acquisition as a business combination. The Company incurred approximately $1.3 million in transaction costs related to the acquisition of which $1.1 million was incurred during three months ended on September 30, 2018. These expenses were recorded in general and administrative expense in the accompanying condensed consolidated statement of operations for the three- and nine-month periods ended September 30, 2018.

The acquisition date fair value of the consideration transferred for Prevoty was approximately $132.8 million, including the following (in thousands):

Cash consideration	$ 132,152
Fair value of equity awards	564
Assumed liability	100
Total purchase consideration	$ 132,816

The purchase consideration reflects the payment of cash consideration of $132.2 million, including cash transferred to selling shareholders and repayment of Prevoty's historical related-party note payable which was accelerated on the closing of the transaction. The purchase consideration is subject to a new working capital adjustment to be finalized by the parties.

In connection with the acquisition, certain Prevoty stock options that were outstanding, unexercised and unvested were assumed and converted into options to purchase Imperva common stock. Separately, certain Prevoty stock options were cancelled and Imperva granted these individuals restricted stock units under the Company's Amended and Restated 2015 Equity Inducement Plan. The amounts included in consideration transferred are amounts attributable to services rendered prior to the closing date.

Additionally, per the terms of the merger agreement, certain Prevoty employees agreed to the imposition of vesting restrictions on a portion of the shares of Prevoty stock held by them prior to the merger. As a result of these restrictions, the Company withheld approximately $17.1 million of the cash proceeds otherwise payable in respect of the revested shares, and is required to pay such withheld amounts to such employees over a time-based vesting schedule, subject to continuing employment. Such amounts are excluded from the purchase consideration above and will be recognized as compensation expense post-acquisition over the vesting period of 3 years.

The following table summarizes the preliminary fair values of assets acquired and liabilities assumed as of the date of acquisition (in thousands):

Cash	$ 8,500
Accounts receivable	1,467
Other current and noncurrent assets	435
Intangible assets	12,100
Deferred revenue, current	(1,377)
Other current liabilities	(447)
Deferred revenue, noncurrent	(918)
Net identifiable assets	19,760
Goodwill	113,056
Total purchase consideration	$ 132,816

Prior to the acquisition, Prevoty had a net deferred tax asset position and Prevoty continues to be in a net deferred tax asset position, after adjustments for deferred tax liability of $5.4 million related to purchase accounting adjustments. The net deferred tax asset is subject to a full valuation allowance. Imperva's U.S. net deferred tax asset was also subject to a full valuation allowance. Therefore, the combined U.S. deferred tax asset position remained unchanged as a result of the acquisition.

The allocation of the purchase price is preliminary, subject to potential future measurement period adjustments, including adjustments relating to certain assumed tax liabilities and net working capital adjustment.

Goodwill

The excess of the consideration for Prevoty over the fair values assigned to the assets acquired and liabilities assumed represents the goodwill resulting from the acquisition. Goodwill is primarily attributable to expected post-acquisition synergies from integrating Prevoty's technology into Imperva's cyber security solutions. Goodwill recorded in connection with the acquisition is not deductible for income tax purposes. The goodwill attributable to the acquisition was recorded as a non-current asset and is not amortized, but is subject to an annual review for impairment.

Identifiable Intangible Assets

The Company determined that Prevoty's separately identifiable intangible assets were developed technology, customer contracts and related relationships, trade names and other. The Company amortizes the acquired intangibles over their estimated useful lives as set forth in the table below.

	Useful life (years)	Fair value
Acquired technology	4.0	$9,500
Customer relationships	2.0	1,800
Trade name and other	3.0	800
Total acquired intangibles		$12,100

Since the Acquisition, we continue to operate in a single operating segment.

The amounts of revenue and pretax loss of Prevoty included in the Company's condensed consolidated statement of operations from the acquisition date in August 2018 were not material to the Company's results of operations.

Pro Forma Consolidated Results of Operations

The following unaudited pro forma results of operations present the combined results of operations of the Company and Prevoty as if the acquisition had been completed at the beginning of fiscal 2017. The historical consolidated financial statements have been adjusted in the pro forma combined financial statements to give effect to pro forma events that are directly attributable to the business combination and factually supportable.

The pro forma information includes adjustments to the amortization expense from acquired intangible assets and the stock-based compensation expense for unvested stock options assumed and restricted stock units granted. In addition, the pro forma consolidated results of operations for the three and nine months ended on September 30, 2018 have been adjusted to include impact of Prevoty's adoption of the new revenue standard as Prevoty, as a private company, had not adopted the new revenue standard prior to the acquisition. The pro forma results for the comparative period include a non-recurring adjustment for transaction costs incurred in connection with the acquisition.

The pro forma data are for informational purposes only and are not necessarily indicative of the consolidated results of operations of the combined business had the acquisition actually occurred at the beginning of fiscal 2017 or of the results of future operations of the combined business. Consequently, actual results may differ from the unaudited pro forma information presented below (in thousands).

	For the three months ended September 30		For the nine months ended September 30	
	2018	2017	2018	2017
Pro forma revenues	$91,891	$84,746	$265,429	$232,959
Pro forma net income (loss)	$(121)	$(4,513)	$(39,144)	$5,954

6. Goodwill and Acquired Intangible Assets

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.

The Company did not have any goodwill impairments during three and nine months ended September 30, 2018 and 2017.

The changes in the carrying amount of goodwill for the period ended September 30, 2018 were as follows (in thousands):

Balance as of January 1	$36,389
Changes during the nine month period	113,056
Balance as of September 30	$149,445

The Company amortizes intangible assets, which consist of purchased technologies that have estimated useful lives ranging from 2 to 10 years, using the straight-line method when the consumption pattern of the asset cannot be reliably determined. The Company reviews such assets for impairment whenever an impairment indicator exists and continually monitors events and changes in circumstances that could indicate carrying amounts of the intangible assets may not be recoverable. When such events or changes in circumstances occur, the Company assesses recoverability by

determining whether the carrying value of such assets exceed the estimates of future undiscounted future cash flows expected to be generated by such assets. Should impairment exist, the impairment loss would be measured based on the excess carrying value of the asset over the asset's estimated fair value. There was no impairment of intangible assets recorded for the three and nine months ended September 30, 2018 and 2017.

Acquired intangible assets subject to amortization are presented as follows (in thousands):

	As of September 30, 2018			
	Weighted Average Remaining Useful life (years)	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Acquired technology	4.1	$13,253	$ (1,874)	$11,379
Customer relationships	3.4	2,280	(253)	2,027
Trade name and other	2.4	1,080	(110)	970
Total acquired intangibles	3.9	$16,613	$ (2,237)	$14,376

	As of December 31, 2017			
	Weighted Average Remaining Useful life (years)	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Acquired technology	6.0	$3,753	$ (1,216)	$2,537
Customer relationships	6.0	480	(71)	409
Trade name and other	6.0	280	(42)	238
Total acquired intangibles	6.0	$4,513	$ (1,329)	$3,184

As of September 30, 2018, the amortization expense in future periods is expected to be as follows (in thousands):

Fiscal Year	Acquired Technology
2018 (remaining 3 months)	1,018
2019	4,071
2020	3,716
2021	3,065
2022	1,967
Thereafter	539
Total expected amortization expense	$ 14,376

7. Commitments and Contingencies

(a) Operating Leases

The Company rents its facilities under operating leases with lease periods expiring through 2023. Future minimum payments under these facility operating leases and minimum rentals to be received under non-cancellable subleases as of September 30, 2018 are as follows (in thousands):

	Operating Leases	Estimated Sublease Income
2018 (remaining 3 months)	1,858	215
2019	8,017	264
2020	5,159	269
2021	863	87
2022	465	87
Thereafter	109	-
Total	$ 16,471	$ 922

Rent expense for the Company's operating leases is recognized on a straight-line basis over the lease term. Rent expense for the nine months ended September 30, 2018 and 2017 was $5.3 million and $4.9 million, respectively.

In connection with leases of office space, the Company may receive tenant improvement allowances from lessors for certain improvements the Company makes to the leased properties. The Company records the tenant improvement allowances as a leasehold improvement within property and equipment, net, and as deferred rent within other liabilities on the condensed consolidated balance sheets. The deferred rent liability is amortized to rent expense over the term of the lease on a straight-line basis. The leasehold improvements are amortized to expense over the period from when the improvements were placed into service until the end of their useful life, which is the end of the lease term. For the three and nine months ending September 30, 2018 and 2017, the Company did not receive any tenant improvement allowances.

In addition, certain of the Company's operating lease agreements for office space also include rent holidays and scheduled rent escalations during the initial lease term. The Company has recorded the rent holidays as a deferred rent within other liabilities on the condensed consolidated balance sheets. The Company recognizes the deferred rent liability and scheduled rent increase on a straight-line basis into rent expense over the lease term commencing on the date the Company takes possession of the lease space.

As of September 30, 2018 and December 31, 2017 the Company had $2.5 million and $2.3 million, respectively, in restricted deposits to secure bank guarantees provided to its lessors.

In September 2018, the Company exited and subleased a portion of its facilities located in Redwood Shores, California and recorded a facility exit cost of $0.6 million in connection with the exit. The facility exit cost is recorded in "General and administrative" expenses.

(b) Cancelable Lease Agreements

The Company leases motor vehicles under cancelable operating lease agreements. The Company has an option to cancel the lease agreements, which may result in penalties in a maximum amount of $0.1 million as of September 30, 2018. Motor vehicle lease expenses for the nine months ended September 30, 2018 and 2017 were $3.6 million and $3.4 million, respectively.

(c) Purchase Commitments

As of September 30, 2018 and December 31, 2017, the Company had purchase commitments of $2.2 million and $2.6 million, respectively, to purchase inventory, trial units, and research and development equipment from its vendors. The purchase commitments result from the Company's contractual obligation to order or build inventory in advance of anticipated sales. According to the Company's agreements with its vendors, the Company is committed to purchase inventory within six months from the date the inventory arrived at the vendor's warehouse.

(d) Litigation

From time to time, the Company may be subject to other legal proceedings and claims in the ordinary course of business.

On August 25, 2017, a purported class action lawsuit was filed against the Company and others, alleging that current, former and prospective employees are entitled to monetary damages for violations of the notice provisions of the Fair Credit Reporting Act (FCRA) and similar California laws governing background checks. The lawsuit was filed in the Superior Court for San Mateo County and on September 29, 2017, the Company removed the action to the U.S. District Court for the Northern District of California. On November 6, 2017, the Company filed a motion to dismiss the action. On April 9, 2018, the court dismissed the complaint in its entirety, with leave to amend as to some counts. The plaintiff filed an amended complaint on May 10, 2018 asserting a claim under the FCRA and no claims under similar California laws.

On August 25, 2017, the same plaintiff filed a second purported class action lawsuit against us and others in the Superior Court for San Mateo County, alleging, among other claims, violation of California wage and hour laws regarding overtime, meal and rest breaks, business expense reimbursement, accurate and complete payroll records and commissions, and seeking unspecified monetary damages, injunctive relief and attorneys' fees. We filed an answer to the complaint on September 29, 2017. On November 3, 2017, the plaintiff amended his complaint to assert an additional representative Private Attorney General Act (PAGA) claim against the Company. On December 6, 2017, we filed an answer to the amended complaint.

In June 2018, through formal mediation, the parties reached an agreement to settle both class action lawsuits. The parties agreed to settle the two class action lawsuits for an aggregate amount of $2.4 million. The respective courts have preliminarily approved the class settlements. Notice of the settlements has been sent to the respective settlement classes. The settlement amount of $2.4 million has been recorded in accrued and other current liabilities.

In addition, the Company has received, and may in the future continue to receive, claims from third parties asserting, among other things, infringement of their intellectual property rights. Future litigation may be necessary to defend the Company, its channel partners and its customers by determining the scope, enforceability and validity of third-party proprietary rights or to establish its proprietary rights.

Except for the above settlement, in the opinion of management, liabilities associated with other claims from third parties, while possible, are not probable at this time, and therefore the Company has not recorded any accrual for them as of September 30, 2018 and December 31, 2017. Further, any possible range of loss cannot be reasonably estimated at this time. The ultimate outcome of any litigation is uncertain and, regardless of outcome, litigation can have an adverse impact on the Company because of defense costs, potential negative publicity, diversion of management resources and other factors. Accordingly, there can be no assurance that existing or future legal proceedings arising in the ordinary course of business or otherwise will not have a material adverse effect on the Company’s business, condensed consolidated financial position, results of operations or cash flows.

(e) Indemnification

Under the indemnification provisions of its standard sales contracts, the Company agrees to defend its end customers and certain channel partners against third-party claims asserting infringement of certain intellectual property rights, which may include patents, copyrights, trademarks, or trade secrets, and to pay judgments and settlements entered on such claims. The Company’s exposure under these indemnification provisions is generally limited to the total amount paid under the agreement. However, some agreements include indemnification provisions that could potentially expose the Company to losses in excess of the amount received under the agreement. To date, there have been no claims under such indemnification provisions. Accordingly, the Company has not recorded a liability on its condensed consolidated balance sheets for these indemnification provisions.

In addition to the foregoing, the Company maintains director and officer insurance, which may cover certain liabilities arising from its obligation to indemnify its directors and officers.

We are also under audit by taxing authorities with regards to income tax matters. We have reserved for potential adjustments to our provision for income taxes that may result from examinations by, or any negotiated agreements with, these tax authorities. Although we believe our tax estimates are reasonable, the final determination of audits could be materially different from our historical income tax provisions and accruals. The results of an audit could have a material effect on our financial position, results of operations, or cash flows in the period for which that determination is made.

8. Stockholders’ Equity and Employee Stock Plans

(a) Preferred Stock

Our board of directors is authorized, subject to any limitations prescribed by law, without stockholder approval, to issue from time to time up to an aggregate of 5,000,000 shares of preferred stock, in one or more series, each series to have such rights and preferences, including voting rights, dividend rights, conversion rights, redemption privileges and liquidation preferences as the Company’s board of directors determines. The rights of the holders of common stock will be subject to, and may be adversely affected by, the rights of holders of any preferred stock that may be issued in the future. The Company currently has no shares of preferred stock outstanding and the Company has no present plans to issue any shares of preferred stock.

(b) 2003 Stock Plan

During 2003, the Board of Directors adopted the 2003 Stock Plan (the “2003 Plan”), which allowed for the grant of both incentive stock options and non-qualified stock options and the direct award or sale of shares of the Company’s common stock (including restricted common stock) to officers, employees, directors, consultants and other key persons. In connection with the Company’s initial public offering, which was completed in November 2011, the Board of Directors determined not to grant any further awards under the 2003 Plan upon completion of the public offering. The 2011 Stock Option and Incentive Plan (the “2011 Plan”) replaced the 2003 Plan in November 2011. Under the 2003 Plan, incentive stock options could have been granted to employees with exercise prices of no less than the fair value of the common stock on the grant date, and non-qualified options could have been granted to employees, directors, or consultants at exercise prices of no less than 85% of the fair value of the common stock on the grant date, as determined by the Board of Directors. If, at the time the Company granted an option, the optionee directly or by attribution owned stock possessing more than 10% of the total combined voting power of all classes of stock of the Company, the option price had to have been at least 110% of the fair value. Options granted under the 2003 Plan generally expire no later than ten years from the date of grant and, in general, vest four years from the date of grant.

(c) 2011 Stock Option and Incentive Plan

In September 2011, the Board of Directors adopted the 2011 Plan which was subsequently approved by the Company's stockholders. The 2011 Plan replaced the 2003 Plan and the Company no longer grants awards under the 2003 Plan. The Company initially reserved a total of 1,000,000 shares of common stock for issuance under the 2011 Plan. In addition, 955,568 reserved but unissued shares under the 2003 Stock Plan were added to the number of shares reserved for issuance under the 2011 Plan. The 2011 Plan also provided that the number of shares reserved and available for issuance under the plan would automatically increase each January 1, beginning in 2012 and ending in 2015, by 4% of the outstanding number of shares of common stock on the immediately preceding December 31. The last automatic increase occurred on January 1, 2015. In May 2016 and April 2017, the Company's stockholders approved an increase to the share reserve under the 2011 Plan by 1,300,000 shares and 850,000 shares respectively.

The 2011 Plan permits the granting of incentive stock options, non-qualified stock options, restricted stock units ("RSUs"), stock appreciation rights, restricted shares of common stock and performance share awards. The exercise price of stock options may not be less than 100% of the fair market value of the common stock on the date of grant.

Options granted pursuant to the 2011 Plan generally expire no later than ten years from the date of grant. The Company also grants RSUs. RSUs granted to new hires and merit grants to existing employees generally vest over a four-year period with 25% vesting at the end of one year and the remainder vesting quarterly thereafter. Additionally, from time to time, the Company grants performance-based RSUs ("PRSUs"). The Company granted PRSUs to its executives to align with the Company's pay-for-performance philosophy. The PRSUs provide for a target number of shares that generally vest over three years which includes a one-year performance period and two years of service-based vesting. The PRSUs vest contingent upon the Company's achievement of financial targets for fiscal 2018 relative to the Company's annual operating plan. The amount of PRSUs earned may vary from zero to 200% of the target award amount depending on the achievement percentage, and provided the award recipient remains employed through each applicable vesting date.

In 2017, the Company awarded PRSUs subject to Company's achievement of an annual contract value for subscription bookings target and total operating expenses for 2017 of 110% or less of the annual operating plan. The PRSUs vest over an eight quarter period from the vesting commencement date through November 2019. Accordingly, the Company recognized an expense of $0.03 million and $0.5 million, respectively for the three and nine months ended September 30, 2018. The Company recorded an expense of $0.4 million and $1.8 million respectively, for the three and nine months ended September 30, 2017.

In 2018, the Company awarded PRSUs to certain employees subject to the Company's achievement of annual revenue growth compared to fiscal year ended December 31, 2017 and annual operating margin targets. Vesting of the PRSUs is expected to occur evenly over an eight quarter period from the vesting commencement date through November 2020. Vesting of the PRSU for one employee is expected to occur evenly over a six quarter period from vesting commencement date through May 2020 and for another employee is expected to occur evenly over a seven quarter period from the vesting commencement date. In August 2018, the Compensation Committee of the Board of Directors approved an amendment to the performance metrics governing the PRSUs. The original performance metrics of revenue growth compared to fiscal year ended December 31, 2017 and annual operating margin targets were amended to total billings for the year ended December 31, 2018 compared to fiscal year ended December 31, 2017 and total operating expense targets. The incremental compensation expense recognized for the three months ended September 30, 2018 was not material. Total expenses recognized for 2018 PRSUs were $0.8 million and $3.1 million, respectively for the three and nine months ended September 30, 2018.

(d) 2011 Employee Stock Purchase Plan

In September 2011, the Board of Directors adopted the 2011 Employee Stock Purchase Plan (the "ESPP") which was subsequently approved by the Company's stockholders. The ESPP took effect on November 8, 2011, the effective date

of the registration statement for the Company's initial public offering. The ESPP permits eligible employees to acquire shares of the Company's common stock by accumulating funds through periodic payroll deductions of up to 15% of base salary. Each offering period may run for no more than 24 months and consist of no more than five purchase periods. The purchase price for shares of the Company's common stock purchased under the ESPP will be 85% of the lesser of the fair market value of the Company's common stock on the first day of the offering period or the last trading day of the applicable purchase period within that offering period.

The Company initially reserved a total of 500,000 shares of common stock for future issuance under the ESPP. The number of shares reserved for issuance under the ESPP increases automatically on January 1 of each of the first eight years commencing in 2012 by the number of shares equal to 1% of the Company's total outstanding shares as of the immediately preceding December 31. The Board of Directors or compensation committee may reduce the amount of the increase in any particular year. No more than 20,000,000 shares of common stock may be issued under the ESPP and no other shares may be added to the ESPP without the approval of the Company's stockholders. On January 1, 2018, the share reserved under the 2011 Employee Stock Purchase Plan were automatically increased by 342,338 shares.

(e) Inducement Stock Option Plan and Agreement and Inducement Restricted Stock Unit Plan and Agreement

In August 2014 and August 2015, the Compensation Committee of the Board of Directors adopted Inducement Stock Option Plans and Agreements (the "Inducement Option Plans") and Inducement Restricted Stock Unit Plans and Agreements (the "Inducement RSU Plans"), in each case created as employment inducement awards. In accordance with the terms of the Inducement Option Plans, the Company issued options to purchase an aggregate of 290,000 shares of the Company's common stock at an exercise price equal to the fair market value of a share of the Company's common stock on the dates of grant of the options. The options, had a ten-year term and vested at the rate of 25% of the shares on each of the first anniversary of the vesting commencement date with an additional 6.25% of the shares subject to the option vesting each quarter thereafter so long as the participant has not been terminated. In accordance with the terms of the Inducement RSU Plans, the Company issued RSUs representing an aggregate of 290,000 shares of the Company's common stock. The RSUs vested at the rate of 25% of the shares on each of the first anniversary of the vesting commencement date with an additional 6.25% of the shares subject to the RSU vesting each quarter thereafter so long as the participant has not been terminated. The recipients of the options and RSUs terminated employment in 2018. As a result, the unvested options and RSUs have ceased vesting and have been cancelled.

(f) 2015 Equity Inducement Plan

In October 2015, the Board of Directors adopted the 2015 Equity Inducement Plan, a non-stockholder approved plan that was subsequently amended and restated to increase the amount of shares available for grant thereunder (the "2015 Plan"). The 2015 plan provides for the granting of stock options and RSUs as employment inducement awards and in connection with acquisitions, subject to compliance with applicable securities laws and stock exchange requirements for such plans. Under the terms of the 2015 Plan, the exercise price of stock options may not be less than 100% of the fair market value of common stock on the date of grant and generally expire no later than ten years from the date of grant.

The Company initially reserved 100,000 shares of common stock for issuance under the 2015 Plan and subsequently increased the number of shares available for grant up to 650,000 shares. During the year ended December 31, 2017, the Company granted 101,200 RSUs under the 2015 Plan and during the nine months ended September 30, 2018, the Company granted an additional 305,808 RSUs under the 2015 Plan.

Option Activity

The following table summarizes option activity under the Plans and related information:

	Options Outstanding		Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
	Number of Shares	Weighted Average Exercise Price	(in years)	(in thousands) (1)
Balances - January 1, 2018	997,674	$ 41.87	5.72	$ 5,689
Granted	-	-		
Assumed in acquisition	141,279	$ 3.60		
Exercised	(227,037)	$ 32.40		

Cancelled or forfeited	(175,017)	$ 52.65		
Balances - September 30, 2018	736,899	$ 34.89	5.32	$ 11,397
Vested and expected to vest - September 30, 2018	736,899	$ 34.89	4.29	$ 11,397
Exercisable - September 30, 2018	563,107	$ 41.46	4.29	$ 5,407

(1) The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the closing stock price of $46.45 of the Company's common stock on September 30, 2018.

The aggregate intrinsic value of options exercised under the Plans was $3.4 million for the nine months ended September 30, 2018. The aggregate intrinsic value is calculated as the difference between the fair market value of the Company's common stock on the date of the exercise and the exercise price of each option multiplied by the number of options exercised.

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RSU Activity

The following table summarizes RSU activity under the Plans and related information:

	Number of Restricted Stock Units Outstanding	Weighted-Average Grant Date Fair Value
Unvested - January 1, 2018	2,353,315	$ 47.42
Granted	1,304,106	$ 45.13
Granted, performance RSUs	478,980	$ 44.60
Released	(787,640)	$ 46.68
Cancelled or forfeited	(809,446)	$ 43.98
Unvested - September 30, 2018	2,539,315	$ 47.04

As of September 30, 2018, total compensation cost related to unvested stock-based awards granted to employees under the Plans, but not yet recognized, was $96.8 million. As of September 30, 2018, this cost will be amortized to expense over a weighted-average remaining period of 2.77 years. Future stock-based award grants will increase the amount of compensation expense to be recorded in these periods.

There was no capitalized stock-based compensation expense during the three and nine months ended September 30, 2018 and 2017.

(g) Stock Compensation Expense

The Company recognized stock-based compensation expense under the 2003 Plan, 2011 Plan, the ESPP, Inducement Option and RSU Plans, the Incapsula 2010 Share Incentive Plan and the 2015 Plan, and Prevoty 2013 Stock Incentive Plan in the condensed consolidated statements of operations as follows (in thousands):

	For the three months ended September 30		For the nine months ended September 30	
	2018	2017	2018	2017
Cost of revenue	$ 2,072	$ 1,343	$ 4,789	$ 4,015
Research and development	2,354	2,584	7,299	9,912
Sales and marketing	3,989	3,850	11,034	11,016
General and administrative	3,566	3,694	14,809	10,970
Restructuring charges	-	-	-	675
Total stock-based compensation expense	$ 11,981	$ 11,471	$ 37,931	$ 36,588

The Company did not issue stock option grants for the three months ended September 30, 2018 and 2017 and nine months ended September 30, 2018 and 2017. In connection with the acquisition of Prevoty, certain Prevoty stock options that were outstanding, unexercised and unvested were assumed and converted into options to purchase the Company's common stock in the three months ended September 30, 2018. See note 5 for more information. The fair value of assumed Prevoty options and ESPP grants for the three and nine months ended September 30, 2018 and 2017 was estimated using the following weighted average assumptions:

	For the three months ended September 30			For the nine months ended September 30			
	2018		2017	2018		2017	
Options assumed in acquisition:							
Dividend rate	0	%	-	0	%	-	
Risk-free interest rate	2.6	%	-	2.6	%	-	
Expected term (in years)	1.61		-	1.61		-	
Expected Volatility	34	%	-	34	%	-	
ESPP grants:							
Dividend rate	-		-	0	%	0	%
Risk-free interest rate	-		-	2.1	%	1.1	%
Expected term (in years)	-		-	0.50		0.50	
Expected Volatility	-		-	37	%	52	%

The fair value of the RSUs is determined using the closing price of the Company's common stock on the date of the grant. Compensation is generally recognized on a straight-line basis over the requisite service period of each grant, except for awards with performance or market conditions for which the accelerated recognition method is used.

9. Accumulated Other Comprehensive Income (Loss)

The changes in the balances of accumulated other comprehensive income (loss) by component are as follows (in thousands):

	For the three months ended September 30, 2018			For the three months ended September 30, 2017		
	Unrealized gain (loss) on cash flow hedges	Unrealized gain (loss) on investments	Total	Unrealized gain (loss) on cash flow hedges	Unrealized gain (loss) on investments	Total
Balance at July 1	$(2,118)	(844)	$(2,962)	$1,083	$ (363)	$720
Other comprehensive income (loss) before reclassifications	66	284	350	128	55	183
Amounts reclassified to net income (loss)	825		825	(1,115)	-	(1,115)
Change in other comprehensive income (loss)	891	284	1,175	(987)	55	(932)
Balance at September 30	(1,227)	(560)	$(1,787)	$96	$ (308)	$(212)

	For the nine months ended September 30, 2018			For the nine months ended September 30, 2017		
	Unrealized gain (loss) on cash flow hedges	Unrealized gain (loss) on investments	Total	Unrealized gain (loss) on cash flow hedges	Unrealized gain (loss) on investments	Total
Balance at January 1	$160	$ (615)	$(455)	$(1,065)	$ (413)	$(1,478)
Other comprehensive income	(2,290)	55	(2,235)	3,254	105	3,359

(loss) before reclassifications						
Amounts reclassified to net income (loss)	903		903	(2,093)	-	(2,093)
Change in other comprehensive income (loss)	(1,387)	55	(1,332)	1,161	105	1,266
Balance at September 30	$(1,227)	$ (560)	$(1,787)	$96	$ (308)	$(212)

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The following is a summary of reclassifications out of accumulated other comprehensive income (loss) for the three and nine months ended September 30, 2018 and 2017 (in thousands):

	For the three months ended September 30, 2018			For the three months ended September 30, 2017		
	Pre-Tax Amount	Tax (Expense) Benefit	After-Tax Amount	Pre-Tax Amount	Tax (Expense) Benefit	After-Tax Amount
Unrealized gains (losses) on cash flow hedges:						
Current period unrealized gain (loss)	$66	$ -	$ 66	$(423)	551	$ 128
Reclassification adjustments [1]	$825	$ -	$ 825	(1,115)	-	(1,115)
Unrealized gains (losses) on cash flow hedges, net	891	-	891	(1,538)	551	(987)
Unrealized gains (losses) on investments:						
Current period unrealized gain (loss)	$284	-	284	$85	(30)	55
Unrealized gains (losses) on investments:	284	-	284	85	(30)	55
Other comprehensive income (loss)	$1,175	$ -	$ 1,175	$(1,453)	$ 521	$ (932)

	For the nine months ended September 30, 2018			For the nine months ended September 30, 2017		
	Pre-Tax Amount	Tax (Expense) Benefit	After-Tax Amount	Pre-Tax Amount	Tax (Expense) Benefit	After-Tax Amount
Unrealized gains (losses) on cash flow hedges:						
Current period unrealized gain (loss)	$(2,290)	-	$ (2,290)	$3,892	(638)	$ 3,254
Reclassification adjustments [1]	903	-	903	(2,093)	-	(2,093)
Unrealized gains (losses) on	(1,387)	-	(1,387)	1,799	(638)	1,161

cash flow hedges, net						
Unrealized gains (losses) on investments:						
Current period unrealized gain (loss)	$55	-	$ 55	$163	(58)	105
Unrealized gains (losses) on investments:	55	-	55	163	(58)	105
Other comprehensive income (loss)	$(1,332)	$ -	$ (1,332)	$1,962	$ (696)	$ 1,266

[1] Refer to note 4 for the affected line items in the condensed consolidated statement of operations.

10. Income Taxes

The Company is subject to income tax in the United States as well as other tax jurisdictions in which it conducts business. For the three months and nine months ended September 30, 2018, the Company recorded an income tax expense of $0.4 million and $19.6 million, respectively. For the three months and nine months ended September 30, 2017, the Company recorded an income tax expense of $0.7 million and $0.8 million, respectively.

The income tax expense for the nine months ended September 30, 2018 includes $19.3 million of additional reserve for unrecognized tax benefits related to its Israeli operations.

The Company is currently under audit by the Israeli Tax Authority. The audit includes the review of various matters, including employee equity based compensation and transfer pricing. On April 22, 2018, the Israeli Supreme Court published a decision, confirming the Tel-Aviv District Court ruling in Kontera Technologies Ltd. vs. Tel Aviv Field Office 3, that expenses for employee equity based compensation should be included in the cost base of an Israeli research and development (R&D) subsidiary implementing a cost-plus arrangement and denied the corresponding tax deduction to the Israeli subsidiary in accordance with the specific provisions of section 102 of the Israeli Income Tax Ordinance. The Company's policy is to review and update tax reserves as facts and circumstances change. The additional tax reserve includes approximately $17.2 million of tax and $2.1 million of interest.

The remaining income tax expense includes tax expense based on our projected effective tax rate for 2018, net of share-based award tax benefit recognized during the quarter.

11. Segment Information

The Company operates its business in one operating segment, which is the development, marketing, sales, service and support of cyber-security solutions that protect business-critical data and applications whether in cloud or on-premises. Operating segments are defined as components of an enterprise that engage in business activities for which separate financial information is available and evaluated by the chief operating decision maker in deciding how to allocate resources and assessing performance. The chief operating decision maker is the Company's Chief Executive Officer.

The Company's net revenue by geographic region, based on the customer's location, is summarized as follows (in thousands):

	Three months ended September 30		Nine months ended September 30	
	2018	2017	2018	2017
Primary geographical markets				
Americas				
United States	$45,217	$42,560	$121,148	$116,906
Other	8,411	6,705	$25,689	22,178
Americas sub-total	$53,628	$49,265	$146,837	$139,084
EMEA	17,611	15,836	53,752	44,458
APAC	20,394	18,791	60,088	47,093
Total revenue	$91,633	$83,892	$260,677	$230,635

The following table presents long-lived assets by location (in thousands):

	As of September 30, 2018	As of December 31, 2017
United States	$ 32,547	$ 23,697
Israel	4,238	4,640
Rest of world	191	254
Total long-lived assets	$ 36,976	$ 28,591

12. Restructuring Charges

In January 2018, the Company implemented a restructuring plan to improve customer experiences, fuel product innovation and increase operational effectiveness. There were no restructuring charges during the three months ended September 30, 2018. The restructuring charge during the nine months ended September 30, 2018 was $2.6 million. The restructuring activity was completed by the end of the first quarter of 2018 and the Company does not expect material costs associated with the activity in future periods. All restructuring charges are reported in Restructuring and other, net in the Condensed Consolidated Statements of Operations.

The Company's restructuring activity is summarized as follows (in thousands):

	Balance as of December 31, 2017	Additions	Adjustments	Cash payments	Balance as of September 30, 2018
Severance and termination-related costs	$ -	$ 2,451	$ -	$ (2,451)	$ -
Legal and other exit costs	-	100	-	(100)	-
Total	$ -	$ 2,551	$ -	$ (2,551)	$ -

	Balance as of December 31, 2016	Additions	Adjustments*	Cash payments	Balance as of September 30, 2017
Severance and termination-related costs	$ 1,132	$ 667	$ (797)	$ (1,002)	$ -
Legal and other exit costs	-	-	-	-	-
Total	$ 1,132	$ 667	$ (797)	$ (1,002)	$ -

* includes amounts representing non-cash stock-based compensation

13. Net Income (Loss) per Share

Basic and diluted net income (loss) per share is computed by dividing net income (loss) by the weighted-average number of common shares outstanding during the period. The computation of net income (loss) per share for each period, including the number of weighted-average shares outstanding, is shown on the face of the condensed consolidated statements of operations. Diluted earnings per share is calculated using our weighted-average outstanding common shares including the dilutive effect of stock awards as determined under the treasury stock method. In periods when the Company recognizes a net loss, the Company excludes the impact of outstanding stock awards from the diluted loss per share calculation as their inclusion would have an antidilutive effect.

The table below shows the reconciliation of the basic and diluted shares for the three and nine months ended September 30, 2018 (in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2018	2017	2018	2017
Weighted average number of shares outstanding:				
Basic	35,066	33,907	34,782	33,590
Dilutive effects of:				
Employee stock options, RSU's and share based payment awards issued to employees	679	-		528

Diluted	35,745	33,907	34,782	34,118

The following outstanding shares of common stock and potential common shares were excluded from the computation of diluted net income (loss) per share of common stock for the three and nine months ended September 30, 2018 and 2017 because the impact of them would have been antidilutive:

	For the three months ended September 30,		For the nine months ended September 30,	
	2018	2017	2018	2017
Stock options to purchase common stock	247,780	1,058,871	736,899	655,411
Restricted stock units for common stock	-	2,538,438	2,539,315	857,047
Employee share purchase plan	-	-	101,019	-

14. Disposition of Business

On February 23, 2017, the Company completed the sale of the assets of its Skyfence cloud access security broker business ("Skyfence") to Forcepoint LLC and its Israeli subsidiary for consideration of approximately $40 million in cash. Of the total consideration, approximately $5.0 million was remitted directly to escrow to secure the Company's indemnification obligations. In the third quarter of 2018, the full escrow amount was released to the Company. As a result of the sale, the Company recognized a gain of $35.9 million during the first quarter of 2017 included in gain on sale of Skyfence in our condensed consolidated statement of operations.

The following table presents the carrying amounts of Skyfence immediately preceding the disposition on February 23, 2017:

	(dollars in thousands)	
Assets		
Prepaid and other current assets	$	46
Property and equipment, net		219
Goodwill		1,058
Acquired intangible assets, net		4,496
Total assets	$	5,819
Liabilities		
Accounts payable	$	104
Accrued and other current liabilities		117
Deferred revenue		1,454
Total liabilities	$	1,675

The Company evaluated the disposition of Skyfence and determined it did not meet the criteria for classification as a discontinued operation and determined that the disposition is not expected to have a material impact to our quarterly consolidated operating loss and net income. However, the Company determined that the disposition does represent an individually significant component of our business. The following table presents certain amounts related to Skyfence in our consolidated results of operations through its disposal on February 23, 2017:

	For the three months ended				For the nine months ended				
	September 30, 2018		2017		September 30, 2018		2017		
	(dollars in thousands)				(dollars in thousands)				
Operating loss	$	-	$	-	$	-	$	(3,567	)
Loss before taxes		-		-		-		(3,648	)
Net loss		-		-		-		(3,659	)

15. Subsequent Event

On October 10, 2018, the Company, Imperial Purchaser, LLC, a Delaware limited liability company (“Newco”), and Imperial Merger Sub, Inc., a Delaware corporation and a wholly owned subsidiary of Newco (“Merger Sub”), entered into an Agreement and Plan of Merger (the “Merger Agreement”) to be acquired by private equity technology investment firm Thoma Bravo, LLC (the “Transaction”). Upon the close of the Transaction, Imperva will operate as a privately-held company. Newco and Merger Sub were formed by an affiliate of private equity investment firm Thoma Bravo. Capitalized terms used in this Note not otherwise defined have the meanings set forth in the Merger

Agreement.

Under the terms of the Merger Agreement, the Company's stockholders will receive $55.75 per share in cash in a transaction valued at approximately $2.1 billion. The Transaction is currently expected to close late in the fourth quarter of 2018 or early in the first quarter of 2019, subject to approval by the Company's stockholders and regulatory authorities and the satisfaction of customary closing conditions, as described in that Current Report on Form 8-K filed with the SEC on October 10, 2018.

The Merger Agreement provides for a 45-day "go-shop" period, during which the Company's Board and advisors may actively solicit alternative acquisition proposals and enter into negotiations with other parties. During this period, the Company will have the right to terminate the Merger Agreement to enter into a superior proposal subject to the terms and conditions of the Merger Agreement. There can be no assurance this 45-day "go-shop" period will result in a superior proposal. The Company does not intend to disclose developments about the "go-shop" process unless and until its Board has made a decision with respect to any potential superior proposal.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the (1) condensed consolidated financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q, and (2) the audited consolidated financial statements and notes thereto and management's discussion and analysis of financial condition and results of operations for the year ended December 31, 2017 included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission, or the SEC, on February 23, 2018. 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, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements are often identified by the use of words such as "may," "will," "expect," "believe," "anticipate," "intend," "could," "estimate," or "continue," and similar expressions or variations. These statements are based on the beliefs and assumptions of our management based on information currently available to management. Such forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified herein, and those discussed in the section titled "Risk Factors," set forth in Part II, Item 1A of this Form 10-Q and in our other SEC filings, including our Annual Report on Form 10-K for the year ended December 31, 2017. You should review the risk factors for a more complete understanding of the risks associated with an investment in our securities. We disclaim any obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

Pending Merger

On October 10, 2018, we announced we had entered into a definitive agreement to be acquired by private equity technology investment firm Thoma Bravo, LLC in an all-cash transaction valued at approximately $2.1 billion. If the Merger is completed, our stockholders will be entitled to receive $55.75 in cash for each share of Imperva common stock they hold as of the effective time of the Merger. The Merger is expected to close in the fourth quarter of 2018 or early in the first quarter of 2019, subject to approval by our stockholders and regulatory authorities, and the satisfaction of other customary closing conditions.

See Note 15, Agreement and Plan of Merger, in the Notes to the Condensed Consolidated Financial Statements in Part I, Item 1 of this Quarterly Report on Form 10-Q, for further details.

Overview

We were incorporated as a Delaware corporation in 2002 with the vision of protecting high-value applications and data assets within the enterprise. Since that time we have been investing in our cyber security solutions to meet the rapidly evolving demands of customers. We shipped our initial web application security and data security products in 2002. In 2006, we expanded our database security product to include compliance features. In 2010, we launched our file security offering. In addition, in 2010, we launched our cloud-based initiatives with ThreatRadar and, in 2011, we introduced our cloud-based offering for mid-market enterprises and small and medium-sized businesses ("SMB") that we provided through Incapsula, Inc., which was majority owned by Imperva, Inc. until March 2014 when we acquired the remaining portion of Incapsula that we did not already own in order to more fully integrate its operations with ours. In January 2014, we acquired certain assets and liabilities of Tomium Software, LLC to accelerate our mainframe data security solutions. In February 2014, we acquired Skyfence Networks Ltd. to further our Software as a Service ("SaaS") delivery models for internally facing corporate applications. In December 2016, we acquired certain assets and liabilities of Camouflage Software, Inc., to further our data masking, security and compliance solutions in the cloud and on-premises. In February 2017, we sold the assets of Skyfence to Forcepoint LLC.

In March 2017, we introduced our FlexProtect hybrid licensing program to give customers access to our on-premises and cloud offerings (hybrid solutions) for data and applications under a single license. At initial introduction, FlexProtect for Applications was available only as a subscription, and FlexProtect for Databases was available only as

a perpetual license. In February 2018, we introduced a subscription offering for FlexProtect for Databases. Designed to give customers the flexibility to use Imperva products, regardless of where data and applications are initially deployed or migrated, Imperva FlexProtect directly supports dynamic hybrid cloud deployments and provides protection to manage this transition. During the second quarter of 2017, we released CounterBreach version 2.0 and announced enhancements to the Incapsula Content Delivery Network. During the second quarter of 2018, we introduced Imperva Attack Analytics. Imperva Attack Analytics is a cloud-based service that applies machine learning to correlate and distill thousands of security events into a few readable security narratives. Attack Analytics is included within FlexProtect for Applications, and available as a separate subscription for SecureSphere WAF and Incapsula.

In January 2018, we announced organizational changes designed to allow us to focus on customers and product innovation and to drive operational efficiencies. The reorganization enabled us to reallocate resources and focus employees on transformation and growth initiatives.

In August 2018, we completed the acquisition of Prevoty. The combination of Imperva and Prevoty will expand customers' security capabilities and their visibility into how applications are accessed, what happens within the applications, and how applications and users interact with data. With this expanded view across their business assets, customers will have deeper insights to help them understand and mitigate security risk.

Our research and development efforts are focused primarily on improving and enhancing our existing cyber-security solutions and services, as well as developing new products and services (including cloud-based services) and conducting advanced security research. We conduct most of our research and development activities in Israel, and we believe this provides us with access to some of the best engineering talent in the security industry. As of September 30, 2018, we had 345 employees dedicated to research and development, including our advanced security research group, the Imperva Defense Center ("IDC"). Our research and development expense was $56.2 million for the nine months ended September 30, 2018 as compared to $47.5 million for the same period in 2017.

We derive our revenue from sales and licenses of our products and sales of our services. Products and license revenue is generated primarily from sales of on-premise software licenses installed on hardware appliances or virtual appliances for our SecureSphere product line. Services revenue consists of subscription services, maintenance and support, professional services and training. A majority of our revenue is derived from customers in the Americas region. In the nine months ended September 30, 2018, 56.3% of our total revenue was generated from the Americas, 20.6% from Europe, Middle East and Africa ("EMEA") and 23.1% from Asia Pacific ("APAC").

We market and sell our products through a hybrid sales model, which combines a direct touch sales organization and an overlay channel sales team that actively assist our extensive network of channel partners throughout the sales process. We also provide our channel partners with marketing assistance, technical training and support. We primarily sell our products and services through our channel partners, including distributors and resellers, which sell to end-user customers, who we refer to in this Quarterly Report on Form 10-Q as our customers. In 2017, over 500 channel partners worldwide sold our products, which included approximately 200 direct resellers and distributors and over 300 indirect resellers. In 2017, our channel partners originated over 57% of our sales and fulfilled almost 84% of our sales. We work with many of the world's leading security value-added resellers, and our partners include some of the largest hosting companies for cloud-based deployments.

As of September 30, 2018, we had 6,430 customers in more than 100 countries. In addition, our solutions are used to protect thousands of organizations through cloud-based deployments with our Software-as-a-Service ("SaaS") customers and our managed security service provider ("MSSP") and hosting partners.

Our net revenue has increased in each of the last three years, growing from $234.3 million in 2015 to $321.7 million in 2017. We incurred net loss of $31.8 million in the nine months ended September 30, 2018, and earned net income of $19.2 million in the nine months ended September 30, 2017. As of September 30, 2018, we had an accumulated deficit of $268.8 million.

Opportunities, Challenges and Risks

We believe that the growth of our business and our future success are dependent upon many factors, including our ability to maintain our technology leadership, improve our sales and marketing, address the needs of smaller enterprises and compete effectively in the marketplace for cyber-security solutions. While each of these areas presents significant opportunities for us, they also pose important challenges and risks that we must successfully address in order to sustain the growth of our business and improve our results of operations.

Maintain Technology Leadership. As a result of the rise in sophisticated attacks by hackers and malicious insiders, the difficulty in complying with regulations governing business data and the growing complexity of, and open access to, data centers, we believe that enterprises are struggling to provide visibility and control over high-value business applications and data assets that they need to protect. In addition, organizations are increasingly taking advantage of

cloud-based services and virtualization technologies, and these new technologies and architectures are increasing the complexity of, and accessibility to, the data center. We believe these challenges are driving the need for a new protection layer positioned closely around the applications and data assets in the data center. We expect that as enterprises recognize the growing risk to high-value business data and the need to comply with increasing regulatory compliance mandates, their spending will increase on solutions designed to control and protect such data. We believe that traditional security and compliance products do not address the evolving needs of enterprises or do not do so adequately, and that this presents us with a large market opportunity. To capitalize on this opportunity, we have introduced and expect that in the future we will need to continue to introduce innovations to our broad business security solutions, including solutions to address cyber-security opportunities that arise as enterprises pursue cloud computing initiatives. We cannot assure you that our products will achieve widespread market acceptance or that we will properly anticipate future customer needs. Moreover, if our products do not satisfy evolving customer requirements, we will not capture the increase in spending that we expect will result from enterprises seeking to secure data across various systems in the data center.

Invest in Our Go To Market Strategy. We are investing in our go to market strategy to improve how we serve our customers and leverage strategic partners in targeted vertical and global markets. We have historically aligned our go-to-market efforts around our products and intend to transition to focus more on our customers. For example, as part of the reorganization we created a Customer Success function to improve the customer experience. In addition, we made substantive changes to our partner program, including an increased focus on our most strategic partners and changes in incentives to align with our mutual outcomes and will also have an increased focus on cloud platforms.

Address Needs of Smaller Enterprises. As market awareness of the benefits of a comprehensive cyber-security solution increases, we believe there is a significant opportunity to provide cyber-security solutions to smaller enterprises as they confront increasing security threats and compliance mandates. To capitalize on this opportunity, we intend to increase our business with mid-market enterprises and SMBs by expanding our cloud-based service offerings and our distribution channel. We have made, and may in the future continue to make, significant investments in our cloud-based security products to address the business security needs of mid-market enterprises and SMBs. If our cloud-based security products, which are relatively new, fail to gain broad acceptance with mid-market enterprises and SMBs, our revenue growth, results of operations and competitive position in our industry could suffer.

Compete Effectively. We operate in an intensely competitive market that has witnessed significant consolidation with large companies acquiring many of our competitors. We track our success rate in competitive sales opportunities against certain competitors, some of which generate higher revenues and have greater market capitalizations than we do, and many of which are more established or have greater name recognition within our industry. Based upon our internal tracking of the results of such competitive sales opportunities, we believe that we have historically competed favorably against our larger competitors, and that we have a proven track record of successfully competing against such larger competitors. Nonetheless, some of our larger competitors have numerous advantages, including, but not limited to, greater financial resources, broader product offerings and more established relationships with channel partners and customers. If we are unable to compete effectively for a share of the business security market, our business, results of operations and financial condition could be materially and adversely affected.

To date, we have incurred, and continue to incur, losses from operations. However, we believe that our existing cash, cash equivalents and short-term investments will be sufficient to meet our working capital and capital expenditure needs for at least the next 12 months. Further, we expect that, if we successfully execute our business plan and strategy, our loss from operations will decline, and that we will reach profitability. Should we need additional cash in the future, we may enter into lines of credit or raise funds through the sale of equity securities.

Key Metrics of Our Business

We monitor the key financial metrics discussed below to help us evaluate growth trends, establish budgets, measure the effectiveness of our sales and marketing efforts and assess operational efficiencies.

Beginning in the second quarter of 2018, we have reported billings in our Quarterly Reports on Form 10-Q.

Net Revenue. We measure our net revenue to assess the acceptance of our products from our customers, our growth in the markets we serve and to help us establish our strategic and operating plans for future periods. We discuss the components of our net revenue in "—Financial Overview—Net Revenue" below.

Gross Margin. We monitor our gross margin to assess the impact on our current and forecasted financial results from any changes to the pricing and mix of products we are selling to our customers.

Deferred Revenue. Our deferred revenue consists of amounts that have been invoiced but that have not yet been recognized as revenue. The majority of our deferred revenue balance consists of the unamortized portion of services revenue from subscription, maintenance and support. We monitor our deferred revenue balance because it represents a significant portion of revenue to be recognized in future periods. We also assess the increase in our deferred revenue

balance plus revenue we recognized in a particular period as a measure of our sales activity for that period. While the change in our deferred revenue and revenue recognized in a given period comprise the majority of our sales activity during that period, they do not constitute the entire sales activity during the period. Our total sales activity also includes sales of products and services for which we have not yet met the criteria to recognize revenue or add such amounts to our deferred revenue balance. Revenue and deferred revenue from these transactions is recognized or recorded in future periods when we have met the required criteria. We discuss for the periods presented deferred revenue further below under "—Results of Operations."

Loss from Operations. We track our loss from operations to assess how effectively we are planning and monitoring our operations as well as controlling our operational costs, which are primarily driven by headcount.

Cash, Cash Equivalents and Short-term Investments. We evaluate the level of our cash, cash equivalents and short-term investments to ensure we have sufficient liquidity to fund our operations, including the development of future products and product enhancements and the expansion into new sales channels and territories.

Net Cash Flow Provided By Operations. We monitor cash flow from operations as a measure of our overall business performance. Our cash flow from operations is driven primarily by sales of our products and licenses, subscription services and from up-front payments from customers under maintenance and support contracts. Our primary uses of cash in operating activities are for personnel-related expenditures, costs of acquiring the hardware used for our appliances, marketing and promotional expenses and costs related to our facilities. Monitoring cash flow from operations enables us to analyze our financial performance without the non-cash effects of certain items such as depreciation and amortization and stock-based compensation expenses, thereby allowing us to better understand and manage the cash needs of our business.

Number of Customers. We believe our customer count is a key indicator of our market penetration, the productivity of our sales organization and the value that our products bring to our customer base. We also believe our existing customers represent significant future revenue opportunities for us.

Billings (Non-GAAP). We define billings as revenue recognized in accordance with GAAP plus the change in deferred revenue from the beginning to the end of the period, net of acquired deferred revenue, and adjustment to the deferred revenue balance due to adoption of the new revenue recognition standard. We consider billings to be a useful metric to manage the business given the company's hybrid-SaaS revenue model, and believe billings provides investors with an important indicator of the health of the business as sales of subscription and support services and related renewals grow. Total billings were $294.5 million for nine months ended September 30, 2018, an increase of 21.5% compared to $242.4 million in the same period last year.

For the periods presented revenue, we discuss gross margin, the components of loss from operations and number of customers further below under "—Results of Operations", as applicable, and we discuss our cash and cash equivalents under "—Liquidity and Capital Resources."

The following represents our key financial and operation metrics:

	Three months ended or As of September 30,		Nine months ended or As of September 30,	
	2018	2017	2018	2017
	(in thousands, except number of customers and percentages)			
Net revenue	$91,633	$83,892	$260,677	$230,635
Gross margin	79.3 %	80.3 %	78.8 %	79.6 %
Loss from operations	$466	$(213)	$(15,145)	$(16,513)
Total deferred revenue	$191,836	$142,271	$191,836	$142,271
Cash, cash equivalents and short-term investments	$304,419	$343,204	$304,419	$343,204
Net cash provided by operations	$32,247	$25,528	$68,575	$49,466
Number of customers	6,430	5,760	6,430	5,760

Billings	$106,523	$92,013	$294,525	$242,435

Financial Overview

Net Revenue

We derive our revenue from sales and licenses of our products and sales of our services.

Our net revenue is comprised of the following:

- Products and License Revenue—Products and license revenue is generated primarily from sales of On-Premises software licenses installed on hardware appliances or virtual appliances for our SecureSphere product line. Our SecureSphere product line consists of database security, file security and web application security. Our other product lines include CounterBreach, Autonomous Application Protection and Camouflage. We offer multiple hardware appliance versions that accompany our SecureSphere software, each with different throughput capacities. Software license revenue is generated from sales of our appliances, licenses for additional users and add-on software modules. Our FlexProtect hybrid licensing program contributes partially to products and license revenue. We also generate a small amount of hardware revenue from sales of spares or replacement appliances, demonstration units and accessories.

- Services Revenue— Services revenue consists of subscription, maintenance and support and professional services and training. Subscription revenue is generated from sales of our cloud-based services such as Incapsula, Attack Analytics and ThreatRadar services as well as our FlexProtect subscription offerings. Incapsula services provide distributed denial of service protection ("DDoS") and load balancing and failover. ThreatRadar services provide reputation and crowdsourced security intelligence services. Maintenance and support revenue is generated from support services that are bundled with appliances and add-on software modules. There are five levels of maintenance and support—Standard, Enhanced, Premium, Select and Select+ —and these are usually offered through agreements for one to three-year terms. Maintenance and support includes major and minor when-and-if available software updates; customer care, which includes our designated support engineer and Imperva resident engineer programs; content updates from our advanced security research group, the IDC, and hardware replacement. Professional services revenue consists of fees we earn related to implementation and consulting services we provide our customers. Training revenue consists of fees we earn related to training customers and partners on the use of our products. We expect subscription revenue will increase as sales of our cloud-based services and sales of FlexProtect subscriptions, continue to increase. We also expect that the services revenue from maintenance and support contracts will continue to grow along with the increase in the size of our installed base, partially offset by expected migration of our installed base to FlexProtect Subscriptions.

A majority of our products and services are sold to customers in the Americas, primarily in the United States, however, a significant portion of our revenue is generated from international sales. See note 11 of "Notes to Condensed Consolidated Financial Statements" for a discussion of our financial information by geographic region.

Cost of Revenue

Our total cost of revenue is comprised of the following:

- Cost of Products and License Revenue—Cost of products and license revenue is comprised primarily of third-party hardware costs and royalty fees. Our cost of products and license revenue also includes personnel costs related to our operations team, shipping costs and write-offs for excess and obsolete inventory.
- Cost of Services Revenue—Cost of services revenue is primarily comprised of personnel costs of our technical support team, our professional consulting services and training teams, our Security Operations Center team, facilities costs, data communication costs, subscription fees and depreciation. We expect that our cost of services revenue will increase in absolute dollars as we increase our headcount and grow our subscription-based business.

Operating Expenses

Our operating expenses consist of research and development, sales and marketing, general and administrative expenses, restructuring charges and amortization of acquired intangible assets. Personnel costs are the most significant component of our operating expenses and consist of wages, benefits, bonuses, stock-based compensation, and with regard to sales and marketing expense, sales commissions. Personnel costs also include stock-based compensation. We expect personnel costs to continue to increase in absolute dollars as we hire additional employees to continue to grow our business.

Research and Development

Our research and development is focused on maintaining and improving our existing products and on new product development. A majority of our research and development expenses are comprised of personnel costs and, to a lesser extent, facility costs, hardware prototype costs, laboratory expenses and depreciation. We expense research and development costs as incurred. We expect our research and development expenses to increase in absolute dollars as we continue to enhance our existing products and develop new products and services that address the emerging market for business security and regulatory compliance.

Sales and Marketing

Sales and marketing expense is the largest component of our operating expenses and consists primarily of personnel costs, including commissions and travel expenses. Sales and marketing expenses also include costs related to marketing and promotional activities, third-party referral fees, facilities costs and depreciation. We expect our sales and marketing expenses to increase in absolute dollars as we expand our sales and marketing efforts worldwide.

General and Administrative

General and administrative expense consists primarily of personnel costs, including stock-based compensation, as well as professional fees, facilities costs and depreciation. General and administrative personnel costs include our executive, finance, order entry, human resources, information technology and legal functions. Our professional fees consist primarily of accounting, external legal, information technology and other consulting costs. We expect our general and administrative expenses to increase in absolute dollars as we hire new employees to continue to grow our business.

Restructuring Charges

In November 2016, we implemented a restructuring plan designed to reduce operating expense through reductions in sales, marketing, and general and administrative headcount and spending generally. We completed the restructuring activities during the first quarter of 2017 and did not incur significant costs related to the plan in subsequent periods. The expenses incurred primarily consisted of employee severance charges and other termination-related costs. In January 2018, we implemented a separate restructuring plan designed to improve customer experiences, fuel product innovation and increase operational effectiveness. We had substantially completed the restructuring activities by the end of the first quarter of 2018 and do not expect material costs associated with the activity in future periods. The expenses incurred primarily consisted of employee severance charges and other termination-related costs.

Amortization of Acquired Intangible Assets

Amortization of acquired intangible assets consists of amortization of intangible assets from the acquisitions of Skyfence and Tomium that occurred in the first quarter of 2014, Camouflage in the fourth quarter of 2016 and Prevoty in the third quarter of 2018. On February 23, 2017, we completed the sale of Skyfence.

Other Income, net

Other income (expense), net is comprised of the following items:

- Interest Income—Interest income consists of interest earned on our cash, cash equivalents and short-term investments. We expect interest income will vary each reporting period depending on our average investment balances during the period and market interest rates.
- Interest Expense—Interest expense consists of interest accrued or paid on debt obligations.
- Foreign Currency Forward Contract Gains (Losses)—Foreign currency forward contract gains and losses pertain to the ineffective portion of derivative instruments designated as hedges that we have entered into primarily to manage our exposure to the variability in expected future expenses resulting from changes in foreign currency exchange rates. We do not use derivative financial instruments for speculative or trading purposes.
- Foreign Currency Exchange Gains (Losses)—Foreign currency exchange gains and losses relate to transactions denominated in currencies other than the U.S. Dollar.

Provision for Income Taxes

The Company is subject to income tax in the United States as well as other tax jurisdictions in which it conducts business. For the three months and nine months ended September 30, 2018, the Company recorded an income tax expense of $0.4 million and $19.6 million, respectively. For the three months and nine months ended September 30, 2017, the Company recorded an income tax expense of $0.7 million and $0.8 million, respectively.

The income tax expense for the nine months ended September 30, 2018, includes $19.3 million of additional reserve for unrecognized tax benefits related to its Israeli operations. The Company is currently under audit by the Israeli Tax Authority. The audit includes the review of various matters, including employee equity based compensation and transfer pricing. On April 22, 2018, the Israeli Supreme Court published a decision, confirming the Tel-Aviv District Court ruling in Kontera Technologies Ltd. vs. Tel Aviv Field Office 3, that expenses for employee equity based compensation should be included in the cost base of an Israeli research and development (R&D) subsidiary implementing a cost-plus arrangement and denied the corresponding tax deduction to the Israeli subsidiary in accordance with the specific provisions of section 102 of the Israeli Income Tax Ordinance. The Company's policy is

to review and update tax reserves as facts and circumstances change. The additional tax reserve includes approximately $17.2 million of tax and $2.1 million of interest.

The remaining income tax expense includes tax expense based on our projected effective tax rate for 2018, net of share-based award tax benefit recognized during the quarter.

Results of Operations

The following table is a summary of our condensed consolidated statements of operations in dollars and as a percentage of our total revenue. We have derived the data for the three and nine months ended September 30, 2018 and 2017 from our condensed consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q.

	For the three months ended				For the nine months ended			
	September 30, 2018		2017		September 30, 2018		2017	
	Amount	% of Net Revenue	Amount	% of Net Revenue	Amount	% of Net Revenue	Amount	% of Net Revenue
	(dollars in thousands)				(dollars in thousands)			
Statement of Operations Data:								
Net revenue:								
Products and license	$23,241	25.4	$26,627	31.7	$62,971	24.2	$66,217	28.7
Services:								
Subscriptions	38,519	42.0	30,956	36.9	109,957	42.2	86,305	37.4
Maintenance and support	25,220	27.5	23,133	27.6	75,393	28.9	67,709	29.4
Professional services and training	4,653	5.1	3,176	3.8	12,356	4.7	10,404	4.5
Total services	68,392	74.6	57,265	68.3	197,706	75.8	164,418	71.3
Total net revenue	91,633	100.0	83,892	100.0	260,677	100.0	230,635	100.0
Cost of revenue:								
Products and license	1,985	2.2	1,883	2.2	5,623	2.2	5,638	2.4
Services	16,997	18.5	14,684	17.5	49,634	19.0	41,455	18.0
Total cost of revenue	18,982	20.7	16,567	19.7	55,257	21.2	47,093	20.4
Gross profit	72,651	79.3	67,325	80.3	205,420	78.8	183,542	79.6
Operating expenses:								
Research and development	18,618	20.4	15,515	18.5	56,219	21.6	47,493	20.6
Sales and marketing	39,051	42.6	38,245	45.6	119,098	45.7	111,757	48.5
General and administrative	13,872	15.1	13,645	16.3	41,789	16.0	39,556	17.2
Restructuring charges	-	-	-	-	2,551	1.0	667	0.3
Amortization of purchased intangibles	644	0.7	133	0.2	908	0.3	582	0.3
Total operating expenses	72,185	78.8	67,538	80.6	220,565	84.6	200,055	86.9
Income (loss) from operations	466	0.5	(213)	(0.3)	(15,145)	(5.8)	(16,513)	(7.3)
Gain on sale of business	-	-	-	-	-	-	35,871	15.6
Other income, net	1,034	1.1	567	0.7	2,983	1.1	633	0.3
Income (loss) before provision for income taxes	1,500	1.6	354	0.4	(12,162)	(4.7)	19,991	8.6
Provision for income taxes	442	0.5	724	0.9	19,620	7.5	768	0.3
Net income (loss)	$1,058	1.1	$(370)	(0.5)	$(31,782)	(12.2)	$19,223	8.3

Comparison of the Three Months Ended September 30, 2018 and 2017

	For the three months ended September 30,					
	2018 Amount	2017 Amount	2018 %	2017 %	Change Amount	%
	(dollars in thousands)		(percentage of revenues)			
Net revenue:						
Products and license	$23,241	$26,627	25.4 %	31.7 %	$(3,386)	-12.7%
Services:						
Subscriptions	38,519	30,956	42.0 %	36.9 %	7,563	24.4 %
Maintenance and Support	25,220	23,133	27.5 %	27.6 %	2,087	9.0 %
Professional Services and Training	4,653	3,176	5.1 %	3.8 %	1,477	46.5 %
Total Services	68,392	57,265	74.6 %	68.3 %	11,127	19.4 %
Total net revenue	$91,633	$83,892	100.0%	100.0%	$7,741	9.2 %
Revenue by geographic region:						
United States	$45,217	$42,560	49.3 %	50.7 %	$2,657	6.2 %
Other	8,411	6,705	9.2 %	8.0 %	1,706	25.4 %
Americas sub-total	53,628	49,265	58.5 %	58.7 %	4,363	8.9 %
EMEA	17,611	15,836	19.2 %	18.9 %	1,775	11.2 %
APAC	20,394	18,791	22.3 %	22.4 %	1,603	8.5 %
Total net revenue	$91,633	$83,892	100.0%	100.0%	$7,741	9.2 %

Three Months Ended September 30, 2018 Compared with Three Months Ended September 30, 2017

Our total net revenue increased $7.7 million, or 9.2%, during the three months ended September 30, 2018 primarily due to increased demand for subscription service offerings. Products and license revenue decreased by $3.4 million during the three months ended September 30, 2018 as customers continue to adopt our subscription service offerings. Services revenue increased by $11.1 million primarily due to the increase in subscription revenue and an increase in maintenance and support revenue from our larger installed base in all regions. Our professional services and training revenue increased by $1.5 million, primarily due to timing of projects.

We had 229 orders exceeding $100,000 during the three months ended September 30, 2018, compared to approximately 195 orders during the three months ended September 30, 2017. As customers migrate to our new FlexProtect hybrid licensing program, we continue to see a portion of product revenue shift to the subscription revenue line. This growth is represented by increased revenue in all regions.

Comparison of the Nine Months Ended September 30, 2018 and 2017

	For the nine months ended September 30,					
	2018 Amount	2017 Amount	2018 %	2017 %	Change Amount	%
	(dollars in thousands)		(percentage of revenues)			
Net revenue:						
Products and license	$62,971	$66,217	24.2 %	28.6 %	$(3,246)	-4.9 %
Services:						
Subscriptions	109,957	86,305	42.2 %	37.5 %	23,652	27.4%
Maintenance and Support	75,393	67,709	28.9 %	29.4 %	7,684	11.3%
Professional Services and Training	12,356	10,404	4.7 %	4.5 %	1,952	18.8%
Total Services	197,706	164,418	75.8 %	71.4 %	33,288	20.2%
Total net revenue	$260,677	$230,635	100.0%	100.0%	$30,042	13.0%
Revenue by geographic region:						
United States	$121,148	$116,906	46.5 %	50.7 %	$4,242	3.6 %
Other	25,689	22,178	9.9 %	9.6 %	3,511	15.8%
Americas sub-total	146,837	139,084	56.3 %	60.3 %	7,753	5.6 %
EMEA	53,752	44,458	20.6 %	19.3 %	9,294	20.9%
APAC	60,088	47,093	23.1 %	20.4 %	12,995	27.6%
Total net revenue	$260,677	$230,635	100.0%	100.0%	$30,042	13.0%

Nine Months Ended September 30, 2018 Compared with Nine Months Ended September 30, 2017

Our total net revenue increased by $30.0 million, or 13.0%, primarily due to increased demand for our cloud-based security services. Products and license revenue decreased by $3.2 million, or 4.9%, as customers continue to adopt our subscription service offerings. Services revenue increased significantly by $33.3 million, or 20.2%, as result of increased demand for our cloud-based subscription security services, in addition to an overall increase in maintenance and support revenue from a larger installed base in all regions. Our professional services and training revenue increased by $2.0 million, or 18.8%, primarily due to timing of projects.

As customers migrate to our new FlexProtect hybrid licensing program and other subscription service offerings, we continue to see a portion of product revenue shift to the subscription revenue line. We had 613 orders exceeding $100,000 during the nine months ended September 30, 2018, compared to 524 orders during the nine months ended September 30, 2017. This growth is represented across all regions mainly due to increasing demand for our service offerings and improved sales execution. Geographically, our growth in net revenue was greatest in APAC (an increase of 27.6% over the nine months ended September 30, 2017), followed by EMEA (20.9%), and the Americas (5.6%).

Gross Profit

	For the three months ended September 30,			For the nine months ended September 30,		
	2018	2017		2018	2017	
	Amount	Amount	% Change	Amount	Amount	% Change
	(dollars in thousands)			(dollars in thousands)		
Products and license gross profit	$ 21,256	$ 24,744		$ 57,348	$ 60,579	
Gross Margin %	91.5 %	92.9 %	(1.4)	91.1 %	91.5 %	(0.4)
Services gross profit	51,395	42,581		148,072	122,963	
Gross Margin %	75.1 %	74.4 %	0.7	74.9 %	74.8 %	0.1
Total gross profit	$ 72,651	$ 67,325		$ 205,420	$ 183,542	
	79.3 %	80.3 %	(1.0)	78.8 %	79.6 %	(0.8)

Three Months Ended September 30, 2018 Compared with Three Months Ended September 30, 2017

Our overall gross margin decreased by 1.0%, to 79.3%, primarily due to the product mix. The services gross margin increased by 0.7% mainly attributable to a greater increase in services revenues compared to corresponding increase in cost of services.

Nine Months Ended September 30, 2018 Compared with Nine Months Ended September 30, 2017

Our overall gross margin decreased by 0.8% to 78.8%, primarily due to the product mix. The services gross margin increased by 0.1% mainly attributable to a greater increase in services revenues compared to corresponding increase in cost of services.

Operating Expenses

	For the three months ended September 30,					
	2018	2017	2018	2017	Change	
	Amount	Amount	%	%	Amount	%
	(dollars in thousands)		(percentage of revenues)			
Operating expenses:						
Research and development	$18,618	$15,515	20.4%	18.5%	$3,103	20.0 %
Sales and marketing	39,051	38,245	42.6%	45.6%	806	2.1 %
General and administrative	13,872	13,645	15.1%	16.3%	227	1.7 %
Restructuring charges	-	-	-	-	-	-
Amortization of acquired intangible assets	644	133	0.7 %	0.2 %	511	384.2%
Total operating expenses [1]	$72,185	$67,538	78.8%	80.6%	$4,647	6.9 %
[1] Includes stock-based compensation expense:						
Research and development	2,354	2,584				
Sales and marketing	3,989	3,850				
General and administrative	3,566	3,694				
Restructuring charges	-	-				
Total stock-based compensation expense	$9,909	$10,128				

Three Months Ended September 30, 2018 Compared with Three Months Ended September 30, 2017

Research and development expenses increased by $3.1 million, or 20.0%. The increase was primarily due to an increase in personnel costs, development tools costs and other allocated facilities and overhead costs.

Sales and marketing expenses increased by $0.8 million, or 2.1%. The increase was principally due to an increase in third-party consulting services and higher allocated costs of facilities and other overhead costs, partially offset by decrease of personnel related costs from lower headcount and from the capitalization of commission expenses pursuant to the adoption of the new revenue standard in 2018.

General and administrative expenses increased by $0.2 million, or 1.7%. The change was primarily due to increase in personnel costs and transaction costs in relation to Prevoty acquisition, partially offset by an increases in allocated facilities and overhead costs to other areas of the Company.

Amortization of acquired intangible assets increased by $0.5 million, or 384.2%. The increase is due to acquisition of Prevoty in the third quarter of 2018.

	For the nine months ended September 30,					
	2018 Amount	2017 Amount	2018 %	2017 %	Change Amount	%
	(dollars in thousands)		(percentage of revenues)			
Operating expenses:						
Research and development	$56,219	$47,493	21.6%	20.6%	$8,726	18.4 %
Sales and marketing	119,098	111,757	45.7%	48.5%	7,341	6.6 %
General and administrative	41,789	39,556	16.0%	17.2%	2,233	5.6 %
Restructuring charges	2,551	667	1.0 %	0.3 %	1,884	282.5%
Amortization of acquired intangible assets	908	582	0.3 %	0.3 %	326	56.0 %
Total operating expenses [1]	$220,565	$200,055	84.6%	86.9%	$20,510	10.3 %
[1] Includes stock-based compensation expense:						
Research and development	7,299	9,912				
Sales and marketing	11,034	11,016				
General and administrative	14,809	10,970				
Restructuring charges	-	675				
Total stock-based compensation expense	$33,142	$32,573				

Nine Months Ended September 30, 2018 Compared with Nine Months Ended September 30, 2017

Research and development expenses increased by $8.7 million, or 18.4%, primarily due to an increase in personnel costs, development tools costs, allocated costs of facilities and other overhead costs.

Sales and marketing expense increased by $7.3 million, or 6.6%, primarily due to an increase in third-party consulting services, increase in legal settlement costs and higher allocated facilities and overhead costs. The increase was offset by decreases in cost of marketing programs and events and reduction in personnel related costs from lower headcount and from the capitalization of commission expenses pursuant to the adoption of the new revenue standard in 2018.

General and administrative expenses increased by $2.2 million, or 5.6%, primarily due to an increase in personnel costs, transaction costs in relation to the Prevoty acquisition and legal fees, partially offset by decreases in travel costs and an increase in allocated facilities and overhead costs to other areas of the Company.

We incurred restructuring charges of $2.6 million during the nine months ended September 30, 2018 in connection with a restructuring plan implemented in January 2018. The restructuring charges primarily represent termination-related expenses and other costs incurred to implement the plan. The restructuring plan was designed to

improve customer experiences, fuel product innovation and increase operational effectiveness. We incurred restructuring charges of $0.7 million during the nine months ended September 30, 2017 in connection with the restructuring plan implemented in November 2016. The November 2016 plan was designed to reduce sales, marketing and general and administrative expenses through reductions in headcount and spending generally.

Amortization of purchased intangibles increased by $0.33 million, or 56%. The increase is due to acquisition of Prevoty in the third quarter of 2018, partially off-set by the sale of acquired intangible assets of Skyfence in the first quarter of 2017.

Income (Loss) from Operations

For the three months ended				For the nine months ended			
September 30,		Change		September 30,		Change	
2018	2017	Amount	%	2018	2017	Amount	%
(dollars in thousands)				(dollars in thousands)			
$466	$(213)	$679	318.8%	$(15,145)	$(16,513)	$1,368	8.3%

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Three Months Ended September 30, 2018 Compared with Three Months Ended September 30, 2017

We generated income from operations of $0.5 million primarily due to higher gross profit partially offset by increase in total operating expenses. The increase in total operating expenses was mainly attributable to facility exit costs, higher personnel cost and third-party consulting services and higher costs of strategic initiatives.

Nine Months Ended September 30, 2018 Compared with Nine Months Ended September 30, 2017

Our loss from operations decreased by $1.4 million primarily due to higher gross profit partially offset by increase in total operating expenses. The increase in total operating expense was mainly attributable to higher facilities and overhead costs, an increase in personnel costs including stock based compensation, increase in third-party consulting costs, an increase in transaction costs in relation to the Prevoty acquisition and higher restructuring charges in connection with the January 2018 restructuring plan.

Gain on Sale of Business

For the three months ended September 30,		Change		For the nine months ended September 30,		Change	
2018	2017	Amount	%	2018	2017	Amount	%
(dollars in thousands)				(dollars in thousands)			
$-	$ -	$-	0.0%	$-	$35,871	$(35,871)	100.0%

On February 23, 2017, we completed the sale of the assets of Skyfence to Forcepoint LLC and its Israeli subsidiary for consideration of approximately $40 million. As a result of the sale, we recognized a gain of $35.9 million during the first quarter of 2017.

Other Income, Net

For the three months ended September 30,		Change		For the nine months ended September 30,		Change	
2018	2017	Amount	%	2018	2017	Amount	%
(dollars in thousands)				(dollars in thousands)			
$1,034	$567	$467	82.4%	$2,983	$633	$2,350	371.2%

Three Months Ended September 30, 2018 Compared with Three Months Ended September 30, 2017

Other income, net increased by $0.5 million, primarily due to interest income from increased short-term investments, a decrease in bank commission expense, and a decrease in amortization of premium/discount on investments and changes in foreign exchange rates.

Nine Months Ended September 30, 2018 Compared with Nine Months Ended September 30, 2017

Other income, net increased by $2.4 million. The change was primarily due to an increase in interest income from increased short-term investments, a decrease in bank commission expense, a decrease in amortization of premium/discount on investment and changes in foreign exchange rates.

Provision for Income Taxes

	For the three months ended				For the nine months ended			
	September 30,		Change		September 30,		Change	
	2018	2017	Amount	%	2018	2017	Amount	%
					(dollars in thousands)			
Provision for income taxes	$442	$724	$(282)	(39)%	$19,620	$768	$18,852	2,455%
Effective tax rate	(29.5)%	(204.5)%			161.3 %	(3.8)%		

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For the three months ended September 30, 2018, we recorded an income tax expense of $0.4 million compared to an income tax expense of $0.7 million for the three months ended September 30, 2017. The income tax expense for the three months ended September 30, 2018 includes tax expense based on the projected effective tax rate for 2018, net of share-based award tax benefit recognized during the quarter. The income tax expense for the three months ended September 30, 2017 was primarily attributable to foreign and state income taxes, partially offset by an intra-period tax benefit allocation related to unrealized gains reported in other comprehensive income.

For the nine months ended September 30, 2018, we recorded an income tax expense of $19.6 million compared to income tax expense of $0.8 million for the nine months ended September 30, 2017. The income tax expense for the nine months ended September 30, 2018 includes $19.3 million of additional reserve for unrecognized tax benefits related to our Israeli operations. The remaining tax expense includes our projected effective tax rate for 2018, net of share-based tax benefit recognized during the quarter. The income tax expense for the nine months ended September 30, 2017 was primarily attributable to foreign and state income taxes including tax effects of the gain related to the sale of Skyfence, partially offset by tax benefits related to share-based award tax benefit and an intra-period tax benefit allocation to the income statement related to unrealized gains reported in other comprehensive income.

Deferred Revenue

	As of September 30,		Change	
	2018	2017	Amount	%
	(dollars in thousands)			
Total deferred revenue	$191,836	$142,271	$49,565	34.8%

Deferred revenue increased $49.6 million, or 35%, primarily attributable to an increase in our subscription based arrangements resulting in higher volume of renewals of subscription and maintenance and support agreements, due to multiyear subscription arrangements, and to a lesser extent, due to new sales of subscription, maintenance and support arrangements, partially offset by decrease of deferred revenue pursuant to the adoption of the new revenue standard in 2018.

Number of Customers

	As of September 30,		Change	
	2018	2017	Amount	%
Number of customers	6,430	5,760	670	11.6%

Our number of customers increased by 670, or 11.6%, to 6,430 as of September 30, 2018. Our growth in customer count was driven by increasing market acceptance of our products. For the purposes of this end customer count, we define end customers as those who purchase directly through our sales force or indirectly through our channel partners.

Billings

	For the three months ended		For the nine months ended	
	September 30,		September 30,	
	2018	2017	2018	2017
	(dollars in thousands)		(dollars in thousands)	
Total Revenue	$ 91,633	$ 83,892	$ 260,677	$ 230,635
Change in deferred revenue	17,185	8,121	32,581	11,800
Adjustment for acquired deferred revenue	(2,295)		(2,295)	
Deferred revenue adjustment due to adoption of the new revenue recognition standard	-	-	3,562	-
Total billings	$ 106,523	$ 92,013	$ 294,525	$ 242,435

Liquidity and Capital Resources

To date, we have satisfied our capital and liquidity needs through sales of our products and services, our initial and follow-on public offerings of common stock, and private placements of convertible preferred stock. We have incurred significant losses as we continue to expand our business. Our cash flows from operating activities will continue to be affected primarily by the extent to which our revenue exceeds or does not exceed any increase in spending on personnel to support the growth of our business. Our largest source of operating cash flow is cash collections from our customers.

Capital Resources

As of September 30, 2018, we had $304.4 million of cash, cash equivalents and short-term investments, $17 million of which is currently held outside of the United States and not presently available to fund domestic operations and obligations. If we were to repatriate cash held outside of the United States, it could be subject to U.S. income taxes on such amounts, less any previously paid foreign income taxes. Our cash, cash equivalents and short-term investments have increased from $17.7 million as of December 31, 2010 to $304.4 million as of September 30, 2018. The largest increases were upon our initial public offering of common stock in November 2011 in which we raised $86.2 million, after deducting underwriters' discounts and offering expenses, our follow-on public offering of common stock in March 2015 in which we raised $127.9 million, after deducting underwriters' discounts and offering costs and proceeds of $40.0 million from the sale of Skyfence in February 2017. This amount was partially offset by our losses from operations as we continued to fund our investments in growth, including the development of future products and product enhancements, and expanded into new sales channels and geographies. In addition, we increased our use of cash through the acquisitions of certain assets of Tomium in January 2014 and Camouflage in December 2016, our acquisitions of Skyfence and Incapsula in February 2014 which included cash consideration totaling approximately $29.4 million and our Prevoty in August 2018, which included cash consideration totaling approximately $132.2 million.

We believe our existing cash, cash equivalents and short-term investments will be sufficient to meet our working capital and capital expenditure needs for at least the next 12 months. Our future capital requirements may vary materially from those currently planned and will depend on many factors, including, among other things, market acceptance of our products, the cost of our research and development activities, the acquisition of other businesses and overall economic conditions.

Cash Flows

The following summary of our cash flows for the periods indicated has been derived from our condensed consolidated financial statements which are included elsewhere in this Quarterly Report on Form 10-Q:

	For the nine months ended September 30,	
	2018	2017
	(dollars in thousands)	
Net cash provided by operating activities	$ 68,575	$ 49,466
Net cash used in investing activities	$ (105,834)	$ (235)
Net cash provided financing activities	$ 1,648	$ 6,573

Cash Flows from Operating Activities

Net cash provided by operating activities of $68.6 million for the nine months ended September 30, 2018 reflected a net loss of $31.8 million, adjusted for non-cash charges of $52.8 million primarily due to stock-based compensation expense of $37.9 million and a depreciation and amortization charge of $8.7 million, as well as a net change of $47.6 million in our net operating assets and liabilities. The net change in our operating assets and liabilities was primarily the result of an increase due to our deferred revenue of $33.8 million, increase in income tax payable by $8.6 million, an increase in accrued and other liabilities of $9.0 million, a decrease in prepaid expenses and other assets of $0.6 million, a decrease in deferred tax assets of $1.0 million, decrease in accounts receivable of $8.7 million partially offset by increase in deferred costs of $14.5 million, and decrease in accounts payable of $0.7 million.

Net cash provided by operating activities of $49.5 million for the nine months ended September 30, 2017 reflected a net income of $19.2 million, adjusted for non-cash charges of $8.1 million and a net change of $22.2 million in our net operating assets and liabilities. The non-cash charges of $8.1 million are primarily due to stock-based compensation expense of $36.6 million and a depreciation and amortization charge of $7.8 million, partially offset by gain on sale of business of $35.9 million. The net change of $22.2 million in our operating assets and liabilities was primarily the result of an increase in our deferred revenue of $13.3 million, a decrease in accounts receivable of $2.8 million, an increase in both accrued compensation and benefits of $4.0 million and accrued and other liabilities of $5.5 million partially offset by a decrease in accounts payable of $1.2 million, increase in deferred tax assets of $1.7 million and increase in prepaid expenses and other assets of $0.8 million.

Cash Flows from Investing Activities

Our investing activities consist primarily of purchases and sales of short-term investments, expenditures to purchase property and equipment, proceeds from sales of business and cash consideration paid in acquisition.

Cash used in investing activities during the nine months ended September 30, 2018 was $105.8 million, primarily resulting from net cash paid for the acquisition of Prevoty of $123.5 million, purchases of short-term investments of $53.3 million and net purchases of property and equipment of $5.7 million, offset by proceeds from the maturities of short-term investments of $71.7 million and receipt of cash in escrow from sale of business of $5.0 million.

Cash used in investing activities during the nine months ended September 30, 2017 was $0.5 million, primarily due to purchases of short-term investments of $91.9 million and capital expenditures of $9.8 million offset by proceeds from disposition of the Skyfence business of $35.0 million, proceeds from the maturities of short-term investments of $66.5 million.

Cash Flows from Financing Activities

Net cash provided by financing activities was $1.6 million for the nine months ended September 30, 2018 primarily as a result of net proceeds from issuance of common stock of $10.8 million, partially offset by shares withheld for tax withholding of $9.2 million.

Net cash provided by financing activities was $6.6 million for the nine months ended September 30, 2017 primarily as a result of net proceeds from issuance of common stock of $14.8 million partially offset by shares withheld for tax withholding of $8.2 million.

Contractual Obligations

The following summarizes our contractual obligations as of September 30, 2018:

	Payments Due by Period						
Contractual Obligations:	2018	2019	2020	2021	2022	Thereafter	Total
	(in thousands)						
Operating lease obligations[1]	$1,858	$8,017	$5,159	$863	$465	$ 109	$16,471
Severance Pay Fund[2]	-	-	-	-	-	-	6,564
Purchase commitments[3]	2,240	-	-	-	-	-	$2,240
Total	$4,098	$8,017	$5,159	$863	$465	$ 109	$25,275

1 Operating lease agreements represent our obligations to make payments under our non-cancelable lease agreements for our facilities. During the nine months ended September 30, 2018, we made regular lease payments of $5.3 million under the operating lease agreements.
2 Our condensed consolidated balance sheet as of September 30, 2018 includes $6.6 million of non-current liabilities for our Israeli severance pay fund. The specific timing of any cash payments relating to this obligation cannot be projected with reasonable certainty and, therefore, no amounts for this obligation are included in the annual columns of the table set forth above.
3 Purchase commitments are non-cancelable contractual obligations to purchase hardware appliances and related component parts from our vendors in advance of anticipated sales, generally within six months from the date the inventory arrived at the vendor’s warehouse.
4 Estimated gross unrecognized tax benefits, including interest, recorded as current taxes payable that relate to ongoing tax examinations of our Israeli subsidiaries by the taxing authority.

Excluded from the table was $10.7 million of unrecognized tax benefits, including interest, that we have recorded in other long-term liabilities for which we cannot make a reasonably reliable estimate of the amount and period of

payment. We do not anticipate any material changes in the next year. See note 10 to our condensed consolidated financial statements for additional information.

Off-Balance Sheet Arrangements

Through September 30, 2018, we did not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Critical Accounting Policies and Estimates

Our condensed consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles ("GAAP") and include our accounts and the accounts of our wholly-owned subsidiaries. The preparation of our condensed consolidated financial statements requires our management to make estimates, assumptions and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the applicable periods. Management bases its estimates, assumptions and judgments

on historical experience and on various other factors that they believe to be reasonable under the circumstances. Different assumptions and judgments would change the estimates used in the preparation of our condensed consolidated financial statements, which, in turn, could change the results from those reported. Our management evaluates its estimates, assumptions and judgments on an ongoing basis.

We believe that the estimates, assumptions and judgments involved in revenue recognition, stock-based compensation, long-lived assets, and accounting for income taxes have the greatest potential impact on our condensed consolidated financial statements, so we consider these to be our critical accounting policies. Historically, our estimates, assumptions and judgments relative to our critical accounting policies have not differed materially from actual results. The critical accounting estimates associated with these policies are described in Part II, Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" of our 2017 Annual Report on Form 10-K for the fiscal year ended December 31, 2017. In August 2018, the Company changed its estimates of the useful lives of its certain equipment to better reflect the estimated periods during which these assets will remain in service. See Note 1 – Basis of Presentation and Summary of Significant Accounting Policies – Recent Accounting Pronouncements in the Notes to condensed consolidated financial statements for further discussion.

Except for the adoption of ASU 2017 - 09 Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting, and ASU No. 2014-09, Revenue from Contracts with Customers (ASC 606), and accounting estimate change of estimated useful lives of property and equipment which have been discussed in detail in the notes to the consolidated financial statements above, there have been no other material changes to our significant accounting policies as compared to the significant accounting policies described in our Annual Report on Form 10-K for the year ended December 31, 2017.

Recent Accounting Pronouncements

See Note 1 – Basis of Presentation and Summary of Significant Accounting Policies – Recent Accounting Pronouncements in the Notes to condensed consolidated financial statements for further discussion.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

There have been no significant changes in our market risk exposures during the three and nine months ended September 30, 2018 as compared to the market risk exposures disclosed in Management's Discussion and Analysis of Financial Condition and Results of Operations, set forth in Part II, Item 7A, of our Annual Report on Form 10-K for the year ended December 31, 2017.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation and supervision of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, or the Exchange Act. In designing and evaluating the disclosure controls and procedures, management recognizes that any 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 the aforementioned evaluation, our chief executive officer and chief financial officer have concluded that as of September 30, 2018, our disclosure controls and procedures are designed at a reasonable assurance level and are effective to provide reasonable assurance that 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 SEC 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 disclosure

and that such controls and procedures provide reasonable assurance that the financial reporting and the preparation of financial statements for external purposes are reliably prepared and reported in accordance with generally accepted accounting principles.

Changes in Internal Control over Financial Reporting

Regulations under the Exchange Act require public companies, including our company, to evaluate any change in our "internal control over financial reporting" as such term is defined in Rule 13a-15(f) and Rule 15d-15(f) of the Exchange Act. In connection with their evaluation of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q, our chief executive officer and chief financial officer did not identify any changes in our internal control over financial reporting during the three months covered by this Quarterly Report that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

On August 25, 2017, a purported class action lawsuit was filed against us and others, alleging that current, former and prospective employees are entitled to monetary damages for violations of the notice provisions of the Fair Credit Reporting Act (FCRA) and similar California laws governing background checks. The lawsuit was filed in the Superior Court for San Mateo County and on September 29, 2017, we removed the action to the U.S. District Court for the Northern District of California. On November 6, 2017 we filed a motion to dismiss the action. On April 9, 2018, the Court dismissed the complaint in its entirety, with leave to amend as to some counts. The plaintiff filed an amended complaint on May 10, 2018 asserting a claim under the FCRA and no claims under similar California laws.

On August 25, 2017, the same plaintiff filed a second purported class action lawsuit against us and others in the Superior Court for San Mateo County, alleging, among other claims, violation of California wage and hour laws regarding overtime, meal and rest breaks, business expense reimbursement, accurate and complete payroll records and commissions, and seeking unspecified monetary damages, injunctive relief and attorneys' fees. We filed an answer to the complaint on September 29, 2017. On November 3, 2017, the plaintiff amended his complaint to assert an additional representative Private Attorney General Act (PAGA) claim against us. On December 6, 2017, we filed an answer to the amended complaint.

In June 2018, through formal mediation, the parties reached an agreement to settle both class action lawsuits. The parties agreed to settle the two class action lawsuits for an aggregate amount of $2.4 million. The respective courts have preliminarily approved the class settlements. Notice of the settlements has been sent to the settlement class.

In addition to the above, from time to time, we may be subject to legal proceedings and claims in the ordinary course of business, including commercial claims, claims from third parties asserting infringement of their intellectual property rights, and claims by employees that are brought on an individual or class action basis alleging wage and hour violations, employment discrimination, unlawful employment practices or other employment law violations. Future litigation may be necessary to defend ourselves. In the case of intellectual property claims, we may also be involved in litigation to defend our channel partners and our customers by determining the scope, enforceability and validity of third-party proprietary rights or to establish our proprietary rights.

The ultimate outcome of any litigation is uncertain and, regardless of outcome, litigation can have an adverse impact on us because of defense costs, potential negative publicity, diversion of management resources and other factors. Accordingly, there can be no assurance that existing or future legal proceedings arising in the ordinary course of business or otherwise will not have a material adverse effect on our business, condensed consolidated financial position, results of operations or cash flows.

Item 1A. Risk Factors

Risks Related to Our Business

The Transaction, the pendency of the Transaction or our failure to complete the Transaction could have a material adverse effect on our business, results of operations, financial condition and stock price.

On October 10, 2018, we entered into the Merger Agreement with Imperial Purchaser, LLC and Imperial Merger Sub, Inc., both of which are entities formed by affiliates of Thoma Bravo, LLC, a private equity investment firm. Completion of the Transaction is subject to the satisfaction of various conditions, including approval of the Transaction by our stockholders, regulatory approvals from various governmental entities, the absence of certain legal impediments and the absence of a material adverse effect on our business. There is no assurance that all of the various conditions will be satisfied, or that the Transaction will be completed on the proposed terms, within the expected timeframe, or at all. Furthermore, there are additional inherent risks in the Transaction, including the risks detailed below.

During the period prior to the closing of the Transaction, our business is exposed to certain inherent risks due to the effect of the announcement or pendency of the Transaction on our business relationships, financial condition, operating results and business, including:

- potential uncertainty in the marketplace, which could lead current and prospective customers to purchase from other vendors or delay purchasing from us;
- the possibility of disruption to our business and operations, including diversion of management attention and resources, increased transaction costs, and the potentially negative impact on our relationships with our partners and suppliers;

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- the inability to attract and retain key personnel, and the possibility that our current employees could be distracted, and their productivity decline as a result, due to uncertainty regarding the Transaction;
- the inability to pursue alternative business opportunities or make changes to our business pending the completion of the Transaction, and other restrictions on our ability to conduct our business;
- our inability to solicit other acquisition proposals during the pendency of the Transaction following the expiration of the 45-day “go-shop” period;
- the amount of the costs, fees, expenses and charges related to the Merger Agreement and the Transaction; and
- other developments beyond our control, including, but not limited to, changes in domestic or global economic conditions that may affect the timing or success of the Transaction.

The Transaction may be delayed, and may ultimately not be completed, due to a number of factors, including:

- the failure to obtain the approval of the Merger Agreement by our stockholders;
- the failure to obtain regulatory approvals from various governmental entities (or the imposition of any conditions, limitations or restrictions on such approvals);
- potential future stockholder litigation and other legal and regulatory proceedings, which could delay or prevent the Transaction; and
- the failure to satisfy the other conditions to the completion of the Transaction, including the possibility that a material adverse effect on our business would permit Thoma Bravo not to close the Transaction.

If the Transaction does not close, our business and stockholders would be exposed to additional risks, including:

- to the extent that the current market price of our stock reflects an assumption that the Transaction will be completed, the price of our common stock could decrease if the Transaction is not completed;
- investor confidence could decline, stockholder litigation could be brought against us, relationships with existing and prospective customers, suppliers and other business partners may be adversely impacted, we may be unable to retain key personnel, and profitability may be adversely impacted due to costs incurred in connection with the pending Transaction.
- the requirement that we pay a termination fee of $25 million (in the event of a qualifying termination during the go-shop period) or $60 million (in the event of a qualifying termination after the go-shop period) to Thoma Bravo if we terminate the Merger Agreement under certain circumstances; and
- the requirement that we reimburse up to $4 million of Thoma Bravo’s transaction expenses upon the termination of the Merger Agreement under specified circumstances.

Even if successfully completed, there are certain risks to our stockholders from the Transaction, including:

- the amount of cash to be paid under the Merger Agreement is fixed and will not be adjusted for changes in our business, assets, liabilities, prospects, outlook, financial condition or operating results or in the event of any change in the market price of, analyst estimates of, or projections relating to, our common stock; and
- the fact that, if the Transaction is completed, our stockholders will forego the opportunity to realize the potential long-term value of the successful execution of our current strategy as an independent company.

We have a history of losses, we may not remain profitable and our revenue growth may not continue.

We incurred net losses in each fiscal year from our inception through 2016. Our net losses in 2016 were $70.3 million. While we generated net income of $22.9 million in 2017, we had an accumulated deficit of $268.8 million as of September 30, 2018. We may not remain profitable in the future if we fail to increase revenue and manage our expenses, or if we incur unanticipated liabilities. Revenue may decline or its growth may slow for a number of possible reasons. Demand for our products or services may slow. Competition may increase. Our overall market may

experience a decline or its growth may slow. We may experience difficulty executing on our go-to-market sales plan. We may fail to capitalize on growth opportunities such as subscription renewals and introducing new products and services. The shift by customers to purchase our products and services on a subscription basis may happen faster than we anticipate. In addition, we have incurred, and anticipate that we will continue to incur, significant legal, accounting and other expenses related to being a public company with global operations. If our revenue does not increase at a rate that proportionally offsets these expected increases in operating expense, our operating margins will suffer. Further, in future periods, our revenue could decline and, accordingly, we may not be able to sustain profitability and our net losses may increase. We may not be able to sustain or increase profitability on a consistent basis. Any failure by us to maintain or increase profitability and continue our revenue growth could cause the price of our common stock to materially decline.

Our quarterly operating results have and are likely to continue to vary significantly and to be unpredictable, which could cause the trading price of our stock to decline.

Our revenue and operating results have and could continue to vary significantly from period to period as a result of a variety of factors, many of which are outside of our control. As a result, comparing our revenue and operating results on a period-to-period basis may not be meaningful, and you should not rely on our past results as an indication of our future performance. We may not be able to accurately predict our future revenue or results of operations. We base our current and future expense levels on our operating plans and sales forecasts, and our operating costs are relatively fixed in the short-term. As a result, we may not be able to reduce our costs sufficiently to compensate for an unexpected shortfall in revenue, and even a small shortfall in revenue could disproportionately and adversely affect financial results for that quarter. If our revenue or operating results fall below the expectations of investors or any securities analysts that cover our stock, the price of our common stock could decline substantially.

In addition to other risk factors listed in this section, factors that may individually or cumulatively affect our operating results from period to period include:

- the level of demand for our products and services, and the timing of orders from channel partners and customers;
- the timing of sales and shipments of products during a quarter, which may depend on many factors such as inventory and logistics and our ability to ship new products on schedule and accurately forecast inventory requirements;
- the mix of products sold, the mix of revenue between products and services, including subscription services, and the degree to which products and services are bundled and sold together for a package price;
- the budgeting, procurement and work cycles of our customers, which may result in seasonal variation as our business and the market for solutions such as ours mature;
- changes in customer renewal rates for our services;
- general economic conditions, both domestically and in our foreign markets, and economic conditions specifically affecting industries in which our customers participate;
- the timing of satisfying revenue recognition criteria for our sales, including shipping and delivery terms, particularly where we accrue the associated commission expense in a different period, which may be affected by the extent to which we bring on new resellers and distributors, and our ability to establish that the customer has obtained control of the promised services;
- future accounting pronouncements or changes in our accounting policies; and
- increases or decreases in our expenses caused by fluctuations in foreign currency exchange rates, since a significant portion of our expenses are incurred and paid in the Israeli shekel and other currencies besides the U.S. dollar.

Reliance on a concentration of shipments at the end of the quarter could cause our revenue to fall below expected levels, resulting in a decline in our stock price.

We tend to receive a significant portion of sales orders and generate a significant majority of product revenue during the last two weeks of each quarter. This pattern is due in part to customer buying habits and the efforts of our sales force and channel partners to meet or exceed quarterly quotas. The fact that so many orders arrive at the end of a quarter means that our revenue may shift from one quarter to the next if we cannot fulfill all of the orders and satisfy all of the revenue recognition criteria under our accounting policies before the quarter ends. If expected revenue at the end of any quarter is delayed because anticipated purchase orders fail to materialize, our logistics partners fail to ship or deliver products on time, we fail to manage our inventory properly, we fail to release new products on schedule, or for any other reason, then our revenue for that quarter could fall below our expectations or those of securities analysts and investors, resulting in a decline in our stock price.

We rely on third party channel partners to generate a significant portion of, and to fulfill a substantial majority of, our sales. If we fail to expand and manage our distribution channels, our revenue could decline and our growth prospects could suffer.

In 2017, our channel partners originated over 57%, and fulfilled almost 84%, of our sales, and we expect that channel sales will represent a substantial portion of our revenue for the foreseeable future. Our ability to expand our distribution channels depends in part on our ability to educate our channel partners about our products and services, which are often complex. Our agreements with our channel partners are generally non-exclusive and many of our channel partners have more established relationships with our competitors. If our channel partners choose to place greater emphasis on products and services of their own or those offered by our competitors, our ability to grow our business and sell our products may be adversely affected. If our channel partners do not effectively market and sell our products and services, or if they fail to meet the needs of our customers, then our ability to grow our business and sell our products may be adversely affected. The loss of one or more of our larger channel partners, who may cease

marketing our products with limited or no notice, and our possible inability to replace them could adversely affect our sales. Our failure to recruit additional channel partners, or any reduction or delay in their sales of our products and services or conflicts between channel sales and our direct sales and marketing activities could materially and adversely affect our revenue.

We face intense competition, especially from larger, better-known companies and we may lack sufficient financial or other resources to maintain or improve our competitive position.

The market for cyber security products is intensely competitive and we expect competition to intensify in the future. Our competitors include companies such as Akamai Technologies, Inc., F5 Networks, Inc., International Business Machines Corporation, Oracle Corporation, McAfee, Inc. and other point solution security vendors.

Many of our existing and potential competitors may have substantial competitive advantages such as:

- greater name recognition and longer operating histories;
- larger sales and marketing budgets and resources and the capacity to leverage their sales efforts and marketing expenditures across a broader portfolio of products;
- broader, deeper or otherwise more well-established relationships with customers, potential customers and channel partners;
- broader distribution networks and more established relationships with distributors;
- wider geographic presence;
- access to larger customer bases;
- greater customer support resources;
- greater resources to make acquisitions;
- greater resources to develop and introduce products that compete with our products;
- lower labor and development costs; and
- substantially greater financial, technical and other resources.

As a result, they may be able to adapt more quickly and effectively to new or emerging technologies and changing opportunities, standards or customer requirements. In addition, these companies could reduce the price of their competing products, resulting in intensified pricing pressures within the markets in which we compete. Further, some of our larger competitors have substantially broader product offerings and leverage their relationships based on other products or incorporate functionality into existing products in a manner that discourages customers from purchasing our products.

Our competitors may offer a bundled product offering, and our customers may elect to accept this offering from our competitors, even if it has more limited functionality than our product offering, instead of adding the additional appliances required to implement our offering. The consolidation in the cyber security industry increases the likelihood of competition based on integration or bundling, particularly where our competitors' products and offerings are effectively integrated, and we believe that consolidation in our industry may increase the competitive pressures we face on all our products and services. If we are unable to differentiate our products and services from the integrated or bundled products of our competitors, such as by offering specialized functionality, performance or value, we may see a decrease in demand for those products or services, which would adversely affect our business, operating results and financial condition. Further, it is possible that continued industry consolidation may impact customers' perceptions of the viability of smaller or even medium-sized software companies and consequently customers' willingness to purchase from companies of our size. Similarly, if customers seek to concentrate their software purchases in the product portfolios of a few large providers or have already deployed products that are similar to ours, we may be at a competitive disadvantage notwithstanding the superior performance that we believe our products and services can deliver. Larger competitors are also often in a better position to withstand any significant reduction in capital spending by customers, and will therefore not be as susceptible to economic downturns.

Many of our smaller competitors that specialize in providing protection from a single type of cyber security threat may deliver these specialized cyber security products to the market more quickly than we can or may introduce innovative new products or enhancements before we do. Conditions in our markets could change rapidly and significantly as a result of technological advancements.

We may not compete successfully against our current or potential competitors. Companies competing with us may introduce products that have greater performance or functionality, are easier to implement or use, or incorporate technological advances that we have not yet developed or implemented. Our current and potential competitors may also establish cooperative relationships among themselves or with third parties that may further enhance their resources. In addition, companies competing with us may price their products more competitively than ours, or have an entirely different pricing or distribution model. Increased competition could result in fewer customer orders, price reductions, reduced operating margins and loss of market share. Further, we may be required to make substantial additional investments in research and development and marketing and sales in order to respond to such competitive threats, and we cannot assure you that we will be able to compete successfully in the future.

We operate in an evolving market that has not yet reached widespread adoption. New or existing technologies that may be perceived to address cyber security risks in better ways could gain widespread adoption and supplant some or all of our products and services, making analysis of trends or predictions about our business difficult and potentially weakening our sales and our financial results.

We operate in new, rapidly evolving categories in the cyber security industry that focus on securing our customers' business-critical data and applications. We offer database, file and web application security in an integrated, modular cyber security solution, data breach detection, data masking technology, autonomous runtime application security and cloud-based security services. Because we depend in part on the market's acceptance of our products and services and customers may choose to acquire technologies that are not directly comparable to ours, it is difficult to evaluate trends that may affect our business, including how large the cyber security market will be and what products customers will adopt. For example, organizations that use other security products, such as network firewalls, security information and event management products or data loss prevention solutions, may believe that these security solutions sufficiently protect access to sensitive data. Therefore, they may continue to devote their IT security budgets to these products and may not adopt our cyber security solutions in addition to such products. If customers do not recognize the benefits that our cyber security solutions offer in addition to other security products, then our revenue may not grow as anticipated or may decline, and our stock price could decline.

The introduction of products and services embodying new technologies could render some or all of our existing products and services obsolete or less attractive to customers. Other cyber security technologies exist or could be developed in the future, and our business could be materially and adversely affected if such technologies are widely adopted. We may not be able to successfully anticipate or adapt to changing technology or customer requirements on a timely basis, or at all. Even if customers purchase our products, they may not make repeat purchases or purchase products across our various product families, which trend may be exacerbated by the rapid evolution of our market. As of December 31, 2017, approximately 25% of our customers had purchased products from more than one of our product families. If we are unable to sell additional products from multiple product families to our customers, then our revenue may not grow as anticipated or may decline, and our stock price could decline. If we fail to keep up with technological changes or to convince our customers and potential customers of the value of our solutions even in light of new technologies, our business, financial condition and results of operations could be materially and adversely affected.

In addition, because of our rapidly evolving market, any predictions about our revenue in future periods may not be as accurate as they would be if we operated in a more established market.

If we do not successfully anticipate market needs and opportunities or changes in the legal, regulatory and industry standard landscape and make timely enhancements to our products and develop new products that meet those needs, we may not be able to compete effectively and our ability to generate revenue will suffer.

The cyber security market is characterized by rapid technological advances, changes in customer requirements, including changes driven by legal, regulatory and self-regulatory compliance mandates, frequent new product introductions and enhancements and evolving industry standards in computer hardware and software technology.

Customers and industry analysts expect speedy introduction of software and new functionality to respond to new threats, requirements and risks and we may be unable to meet these expectations. As a result, we must continually improve our products and introduce new solutions in response to changes in operating systems, application software, computer and communications hardware, networking software, data center architectures, programming tools and computer language technology. Moreover, the technology in our products is especially complex because it needs to effectively identify and respond to methods of attack and theft, while minimizing the impact on network, database, file system and web application performance. In addition, our products must successfully interoperate with products from other vendors and across on-premises and cloud environments.

We cannot guarantee that we will be able to anticipate future market needs and opportunities or be able to develop product enhancements or new products to meet such needs or opportunities in a timely manner or at all. Since developing new products or new versions of, or add-ons to, existing products is complex, the timetable for their commercial release is difficult to predict and may vary from our historical experience, which could result in delays in their introduction from anticipated or announced release dates. We may not offer updates as rapidly as new threats affect our customers or our newly developed products or enhancements may have defects, errors or failures. If we do not quickly respond to the rapidly changing and rigorous needs of our customers by developing and introducing on a timely basis new and effective products, upgrades and services that can respond adequately to new security threats, our competitive position, business and growth prospects will be harmed.

Even if we are able to anticipate, develop and commercially introduce enhancements and new products, there can be no assurance that we will be successful in developing sufficient market awareness of them or that such enhancements or new products will achieve widespread market acceptance. Diversifying our product offerings will require significant investment and planning, will bring us more directly into competition with software providers that may be better established or have greater resources than we do, will require additional investments of time and resources in the development and training of our channel and strategic partners and will entail a significant risk of failure.

Further, one factor that drives demand for our products and services is the legal, regulatory and industry standard framework in which our customers operate, which we expect will continue to be a factor for the foreseeable future. For example, many of our customers purchase our web application security products to help them comply with the security standards developed and maintained by the Payment Card Industry Security Standards Council, which apply to companies that process or store credit card information. Laws, regulations and industry standards are subject to drastic changes that, particularly in the case of industry standards, may arrive with little or no notice, and these could either help or hurt the demand for our products. If we are unable to adapt our products and services to changing regulatory standards in a timely manner, or if our products fail to assist our customers with their compliance initiatives, our customers may lose confidence in our products and could switch to competing solutions. In addition, if regulations and standards related to cyber security are changed in a manner that makes them less onerous, our customers may view government and industry regulatory compliance as less critical to their businesses, and our customers may purchase fewer of our products and services, or none at all. In either case, our sales and financial results would suffer.

Real or perceived errors, failures or bugs in our products, particularly those that result in our customers experiencing security breaches, could adversely affect our reputation and business could be harmed.

Our products and services are very complex and have contained and may contain undetected defects or errors, especially when first introduced or when new versions are released. Defects in our products may impede or block network traffic or cause our products or services to fail to help secure business-critical data and applications. Defects in our products may lead to product returns and require us to implement design changes or software updates. Any defects or errors in our products, or the perception of such defects or errors, could result in:

- expenditure of significant financial and product development resources in efforts to analyze, correct, eliminate or work around errors or defects;
- loss of existing or potential customers or channel partners;
- delayed or lost revenue;
- delay or failure to attain market acceptance;
- delay in the development or release of new products or services;
- negative publicity, which will harm our reputation;
- warranty claims against us, which could result in an increase in our provision for doubtful accounts;
- an increase in collection cycles for accounts receivable or the expense and risk of litigation; and
- harm to our results of operations.

Data thieves are sophisticated, often affiliated with organized crime and operate large-scale and complex automated attacks. In addition, their techniques change frequently and generally are not recognized until launched against a target. If we fail to identify and respond to new and complex methods of attack and to update our products to detect or prevent such threats in time to protect our customers' business-critical data and applications, our business and reputation will suffer.

In addition, many of our customers use our products in applications that are critical to their businesses and may have a greater sensitivity to defects in our products than to defects in other, less critical, software products. An actual or perceived security breach or theft of the business-critical data of any of our customers, regardless of whether the breach is attributable to the failure of our products or services, could adversely affect the market's perception of our security products. Despite our best efforts, there is no guarantee that our products will be free of flaws or vulnerabilities, and, even if we discover these weaknesses, we may be unable to correct them promptly, if at all. Our customers may also misuse our products, which could result in a breach or theft of business-critical data.

Although we have limitation of liability provisions in our standard terms and conditions of sale, they may not fully or effectively protect us from claims as a result of federal, state or local laws or ordinances or unfavorable judicial decisions in the United States or other countries. The sale and support of our products also entail the risk of product liability claims. We maintain insurance to protect against certain claims associated with the use of our products, but our insurance coverage may not adequately cover all claims asserted against us, or cover only a portion of such claims. In addition, even claims that ultimately are unsuccessful could result in our expenditure of funds in litigation or other resolutions strategies and divert management's time and other resources.

False detection of security breaches or false identification of malicious sources could adversely affect our business.

Our cyber security products may falsely detect threats that do not actually exist. For example, our ThreatRadar Reputation Services product relies on information on attack sources aggregated from third-party data providers who monitor global malicious activity originating from anonymous proxies, specific IP addresses, botnets and phishing sites. Our Attack Analytics product aggregates event data from our SecureSphere and Incapsula web application firewalls to identify attack patterns for customers. If the information from these data sources is inaccurate, the potential for false positives increases. These false positives, while typical in the industry, may affect the perceived reliability of our products and may therefore adversely impact market acceptance of our products. If our products and services restrict access to important databases, files or applications based on falsely identifying users or traffic as an attack or otherwise unauthorized, then our customers' businesses could be adversely effected. Any such false identification of users or traffic could result in negative publicity, loss of customers and sales, increased costs to remedy any problem and costly litigation.

Our success in acquiring and integrating other businesses, products or technologies could impact our financial position.

In order to remain competitive, and build upon our product strategy, we may seek to acquire additional businesses, products or technologies, any of which could be material to our business, operating results and financial condition. For example, on August 9, 2018, we announced that we had consummated our acquisition of Prevoty, Inc., a leader in runtime application self-protection software. Prior to that, we acquired assets from Camouflage Software Inc. in December 2016, completed our acquisition of the remaining shares of Incapsula, Inc. in March 2014, acquired the outstanding shares of Skyfence Networks Ltd. in February 2014 and acquired assets from Tomium Software, LLC in January 2014. The environment for acquisitions in the markets in which we operate is very competitive and acquisition candidate purchase prices will likely exceed what we would prefer to pay, but we may be required to pay high purchase prices nonetheless in order to make an acquisition. Furthermore, we may not find suitable acquisition candidates, and acquisitions we complete may be difficult to successfully integrate into our overall business. Achieving the anticipated benefits of future acquisitions will depend in part upon whether we can integrate acquired operations, products and technology in a timely, strategic and cost-effective manner.

Acquisitions involve many risks. Acquisitions could negatively impact our results of operations for a number of reasons including if:

- an acquisition requires us to incur charges, substantial debt or liabilities;
- an acquisition causes adverse tax consequences, substantial depreciation or deferred compensation charges;

- an acquisition results in acquired in-process research and development expenses or in the future may require the amortization, write-down or impairment of amounts related to deferred compensation, goodwill and other intangible assets;
- an acquisition does not generate sufficient financial return to offset acquisition costs;
- we encounter difficulties or unforeseen expenditures integrating the technologies, products, personnel or operations of any company that we acquire, particularly if key personnel of the acquired company decide not to work for us;
- the acquisition and integration process is complex, expensive and time consuming, and disrupts our ongoing business, diverts resources, increases expense or distracts management;
- an acquisition results in a delay or reduction of customer purchases both for us and the company acquired due to customer uncertainty about continuity and effectiveness of service from either company;

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- we encounter difficulties in, or are unable to, successfully sell any acquired products;
- we obtain unanticipated or unknown liabilities or become exposed to unanticipated risks in connection with any acquisition; and
- an acquisition involves the entry into geographic or business markets in which we have little or no prior experience.

If we are unable to effectively execute acquisitions, our business, financial condition and results of operations could be materially and adversely affected.

From time to time, we may seek to divest or wind down portions of our business that are no longer core to our strategy, which could materially affect our results of operations and result in disruption to other parts of the business.

The cyber security market is subject to rapid change and development, and from time to time we may need to revisit the strategic focus of our business and seek to divest or wind down business segments that are no longer core to our strategy. For example, in February 2017, we completed the sale of our former Skyfence assets to Forcepoint LLC.

Any dispositions we make may involve risks and uncertainties, including our ability to sell these businesses on terms acceptable to us, or at all. In addition, any such dispositions could result in disruption to other parts of our business, potential loss of employees, customers or revenue, exposure to unanticipated liabilities or result in ongoing obligations and liabilities to us following any such divestiture. For example, in connection with a disposition, we may enter into transition services agreements or other strategic relationships, including long-term research and development or sales arrangements, or agree to provide certain indemnities to the purchaser in any such transaction, which may result in additional expense and may adversely affect our financial condition and results of operations. In addition, dispositions may include the transfer or division of technology and/or the licensing of certain IP rights to third party purchasers, which could limit our IP rights or our ability to assert our IP rights against such purchasers or other third parties.

If we are unable to improve our systems and processes, our operating results will be negatively affected.

We rely heavily on information technology systems to help manage critical operating activities, such as customer relationship management, customer success, support and training, sales forecasting, demand generation, order processing, revenue recognition, financial forecasting, enterprise resource planning, inventory and supply chain management, human resources operations, equity and internal collaboration tools. To manage any future growth effectively, we must continue to improve our information technology and financial infrastructure, operating and administrative systems and controls, and continue to manage headcount, capital and processes in an efficient manner. We may not be able to successfully implement improvements to these systems and processes in a timely manner.

Some of our systems are hosted SaaS technologies from third parties that we use to operate critical functions of our business, including enterprise resource planning services from NetSuite and customer relationship management services from Salesforce.com. If these services become unavailable due to extended outages or interruptions or because they are no longer available on commercially reasonable terms or prices, our expenses could increase, our ability to manage our finances could be interrupted and our processes for managing sales of our products and services and supporting our customers could be impaired until equivalent services, if available, are identified, obtained and integrated, all of which could harm our business.

Our systems and processes may not prevent or detect all errors, omissions or fraud. Our failure to improve our systems and processes, or their failure to operate in the intended manner, may result in our inability to manage the growth of our business and to accurately forecast our revenue, expenses and earnings, or to prevent certain losses. Our productivity and the quality of our products and services may also be adversely affected if we do not integrate and train our new employees quickly and effectively. Any future growth would add complexity to our organization and require effective coordination across our organization. If we fail to achieve the necessary level of efficiency in our organization as it grows or otherwise fail to manage any future growth effectively, we could incur increased costs, and experience a loss of customer and investor confidence in our internal systems and processes, any of which could result in harm to our business, results of operations and financial condition.

If we are unable to hire, retain and motivate qualified personnel, our business will suffer.

In January 2018 we announced and implemented strategy changes that resulted in changes in personnel and have since August 2017 experienced significant changes in the management team. These changes have placed, and will continue to place, a strain on our employees, management systems and other resources. Managing our employee base has required, and will continue to require, significant expenditures and allocation of valuable management resources.

We depend on the continued contributions of our senior management and other key employees to execute on our business plan, and to identify and pursue new opportunities and product innovations. The loss of services of senior management or other key employees, particularly Christopher Hylen, our President and Chief Executive Officer, could significantly delay or prevent the achievement of our development and strategic objectives.

Our future success depends, in part, on our ability to continue to attract and retain highly skilled technical, managerial and other personnel, particularly in our sales and marketing, research and development, professional services and finance departments. Any of our employees may terminate their employment at any time. Competition for highly skilled personnel is frequently intense, globally for sales personnel, as well as in the San Francisco Bay Area and in Tel Aviv and Rehovot, Israel, the locations in which we have a substantial presence and need for highly-skilled personnel. We may be unable to attract and retain suitably qualified individuals who are capable of meeting our growing technical, operational and managerial requirements, on a timely basis or at all, and we may be required to pay increased compensation in order to do so. If we are unable to attract and retain the qualified personnel we need to succeed, our business will suffer.

Volatility or lack of performance in our stock price may also affect our ability to attract and retain our key employees. Employees may be more likely to leave us if the shares or RSUs they hold have declined in value or if the exercise prices of the options that they hold exceed the market price of our common stock. If we are unable to retain our employees, our business, operating results and financial condition will be harmed.

In addition, from time to time, we may rely on strategic acquisitions in order to grow our business, and realizing the benefit of such acquisitions will depend in part on our ability to retain key employees and highly-skilled personnel from the acquired businesses. Differences in location, corporate culture, overall strategy, compensation or other factors may contribute to difficulty in retaining qualified personnel. There is no guarantee that our efforts to retain qualified personnel key to such acquisitions will be successful in the immediate future or over a longer term.

Restructuring activities may not be as effective as anticipated.

In January 2018, we announced a restructuring plan to improve customer experiences, fuel product innovation and increase operational effectiveness. As a result of these changes, we incurred pre-tax restructuring charges of $2.6 million in the nine months ended September 30, 2018, substantially all of which are for cash severance costs. While we anticipate approximately $10.0 million in savings in future periods, which we intend to use to fund incremental investments in new initiatives and growth priorities, we cannot be sure our savings will reach the desired levels, achieve the desired benefits, or improve our results as we expect, or in the time frame that we expect. There may also be unanticipated costs that we will be required to prioritize instead. If we are unable to realize the expected outcomes from the restructuring plan, if our operating costs are higher than we expect or if we do not maintain adequate control of our costs and expenses, our business and operating results may be harmed.

Delays or interruptions in the manufacturing and delivery of SecureSphere appliances by our manufacturers may harm our business.

Our hardware appliances are built by two manufacturers in Taiwan and we rely principally on one of these two manufacturers to build the majority of our hardware appliances. We released entry level products from the second manufacturer for sale in July 2017. Our primary reliance on a single manufacturer for a majority of our hardware revenue, particularly a foreign manufacturer, involves several risks, including a potential inability to obtain an adequate supply of appliances and limited control over pricing, quality and timely delivery of products. In addition, replacing this manufacturer may be difficult and could result in an inability or delay in obtaining products. As a result, we may be unable to fulfill customer orders and our operating results may fluctuate from period to period, particularly if a disruption occurs near the end of a fiscal period.

Our manufacturers' ability to timely manufacture and ship our appliances in large quantities depends on a variety of factors. They rely on a limited number of sources for the supply of functional components, such as semiconductors, printed circuit boards and, to a lesser extent, hard disk drives. Functional component supply shortages or delays could prevent or delay the manufacture and shipment of appliances and, in the event of shortages or delays, we may not be able to procure alternative functional components on similar pricing terms, if at all. In addition, contractual restrictions or claims for infringement of intellectual property rights may restrict our manufacturers' use of certain components. These restrictions or claims may require our manufacturers to utilize alternative components or obtain additional licenses or technologies, and may impede their ability to manufacture and deliver appliances on a timely or cost-effective basis. If at some point, either manufacturer is no longer financially viable, we may lose our source of supply with little or no notice or recourse. Further, even if quality products are timely manufactured, delays in shipping may occur, resulting in delayed satisfaction of a primary revenue recognition criterion.

In the event of an interruption from either manufacturer or any quality control issues with a manufacturer, we may be unable to develop alternate sources in a timely manner. If we are unable to procure our appliances in quantities sufficient to meet our requirements, we will not be able to deliver products to our channel partners and customers, which would materially and adversely affect present and future sales.

A failure to manage excess inventories or inventory shortages could result in decreased revenue and gross margins and harm our business.

We purchase products from our manufacturing partners outside of, and in advance of, reseller or customer orders and hold our products in inventory. If we fail to accurately predict demand and as a result our manufacturers maintain insufficient hardware or component inventory or excess inventory, we may be unable to timely deliver products to our distributors or customers or may have substantial inventory expense. Because our channel partners do not purchase our products in advance of customer orders, our difficulty in accurately forecasting demand for our hardware products may be exacerbated. There is a risk we may incorrectly forecast demand and may be unable to sell excess products ordered from our manufacturing partners. Inventory levels in excess of customer demand may result in inventory write-downs, and the sale of excess inventory at discounted prices could significantly impair our brand image and have an adverse effect on our financial condition and results of operations.

Conversely, if we underestimate demand for our products or if our manufacturing partners fail to supply products we require in a timely manner, we may experience inventory shortages. Inventory shortages might delay shipments to resellers, distributors and customers or cause us to lose sales. Further, as the size of individual orders increases, the risk that we may be unable to deliver unforecasted orders also increases, particularly near the end of quarterly periods. These shortages may diminish the loyalty of our channel partners or customers.

The difficulty in forecasting demand also makes it difficult to estimate our future financial condition and results of operations from period to period. A failure to accurately predict the level of demand for our products could adversely affect our net revenue and net income, and we are unlikely to forecast such effects with any certainty in advance.

We have operations outside of the United States and a significant portion of our customers and suppliers are located outside of the United States, which subjects us to a number of risks associated with conducting international operations.

We market and sell our products throughout the world and have personnel in many parts of the world. In addition, we have sales offices and research and development facilities outside the United States and we conduct, and expect to continue to conduct, a significant amount of our business with companies that are located outside the United States, particularly in Israel, Asia, Europe and Latin America. We also source our components for our products and deliver our services from various geographical regions. Therefore, we are subject to risks associated with having international sales and worldwide operations, including:

- challenges caused by distance, language, cultural and ethical differences and the competitive environment;
- multiple and conflicting laws and regulations, including complications due to unexpected changes in these laws and regulations;
- trade and foreign exchange restrictions;
- foreign currency exchange fluctuations and foreign exchange controls;
- economic, social or political instability in foreign markets;
- greater difficulty in enforcing contracts, accounts receivable collection and longer collection periods;
- changes in regulatory requirements;
- difficulties and costs of staffing and managing foreign operations or relationships with channel partners;
- the uncertainty and limitation of protection for intellectual property rights in some countries;
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costs of complying with U.S. and foreign laws and regulations, including import and export control laws, tariffs, trade barriers, economic sanctions and other regulatory or contractual limitations on our ability to sell our products in certain foreign markets, and the risks and costs of non-compliance or complaints of non-compliance;

- heightened risks of unethical, unfair or corrupt business practices, actual or claimed, in certain geographies and of improper or fraudulent sales arrangements that may impact financial results and result in restatements of, and irregularities in, financial statements;
- the potential that our operations in the U.S. may limit the acceptability of our products to some foreign customers, and that our international sourcing and operations may limit the acceptability of our products to some U.S. customers;

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- the potential for acts of terrorism, hostilities or war;
- management communication and integration problems resulting from cultural differences and geographic dispersion; and
- multiple and possibly overlapping tax structures.

Our product and service sales may be subject to foreign governmental regulations, which vary substantially from country to country and change from time to time. Failure to comply with these regulations could adversely affect our business. Violations of laws or key control policies by our employees, contractors, channel partners or agents could result in delays in revenue recognition, financial reporting misstatements, fines, penalties or the prohibition of the importation or exportation of our products and services and could have a material adverse effect on our business and results of operations.

A portion of our revenue is generated by sales to government entities and such sales are subject to a number of challenges and risks.

Sales to U.S. and foreign federal, state and local governmental agency customers across all product lines for the years ended December 31, 2016 and 2017 was approximately 10% and 9% of bookings, respectively, and 8% for the nine months ended September 30, 2018. Sales to government entities are subject to a number of risks. Selling to government entities can be highly competitive, expensive and time consuming, often requiring significant upfront time and expense without any assurance that we will complete a sale. Governments and governmental agencies may delay or refrain from purchasing our products and services in the future for the following reasons, which would have an adverse effect on our business, financial condition and results of operations:

- changes in fiscal or contracting policies or decreases and uncertainties in available government funding;
- changes in government programs or applicable requirements;
- the adoption of new laws or regulations or changes to existing laws or regulations;
- changes in political or social attitudes with respect to security issues; and
- potential delays or changes in the government appropriations process, including actions such as spending freezes implemented to address political or fiscal policy concerns.

Most of our sales to government entities have been made indirectly through our channel partners. Government entities may have contractual or other legal rights to terminate contracts with our distributors and resellers for convenience or due to a default, and any such termination may adversely impact our results of operations.

In addition, for purchases by the U.S. federal government, we must comply with laws and regulations relating to U.S. federal government contracting, which affect how we and our channel partners do business in connection with U.S. federal agencies. These laws and regulations may impose added costs on our business, and failure to comply with these or other applicable regulations and requirements, including non-compliance in the past, could lead to claims for damages from our channel partners, penalties, termination of contracts and suspension or debarment from government contracting for a period of time. Any such damages, penalties, disruption or limitation in our ability to do business with the U.S. federal government may adversely impact our results of operations.

Our business in countries with a history of corruption and transactions with foreign governments increase the risks associated with our international activities.

As we operate and sell internationally, we are subject to the U.S. Foreign Corrupt Practices Act ("FCPA") and other laws that prohibit improper payments or offers of payments to foreign governments and their officials and political parties for the purpose of obtaining or retaining business. We have operations, deal with and make sales to governmental customers in countries known to experience corruption, particularly certain emerging countries in Africa, East Asia, Eastern Europe, South America and the Middle East. Our activities in these countries create the risk of unauthorized payments or offers of payments by one of our employees, consultants, sales agents or channel partners that could be in violation of various anti-corruption laws, even though these parties may not be under our control. While we have implemented safeguards to prevent these practices by our employees, consultants, sales agents and

channel partners, our existing safeguards and any future improvements to our processes may prove to be less than effective, and our employees, consultants, sales agents or channel partners may engage in conduct for which we might be held responsible. Violations of the FCPA may result in severe criminal or civil sanctions, including suspension or debarment from U.S. government contracting, and we may be subject to other liabilities, which could negatively affect our business, operating results and financial condition.

We rely significantly on revenue from maintenance and support which may decline and, because we recognize revenue from such services over the term of the relevant service period, downturns or upturns in sales are not immediately reflected in full in our operating results.

Our maintenance and support revenue accounted for 30% of total revenue for 2016, 28% of total revenue for 2017, and 29.4% of revenue for the nine months ended September 30, 2018. Sales of new maintenance and support contracts or renewal of such services contracts may decline or fluctuate as a result of a number of factors, including customers' level of satisfaction with our products and services, the prices of our products and services, the prices of products and services offered by our competitors or reductions in our customers' spending levels. If our sales of new or renewal services contracts decline, our revenue or revenue growth may decline and our business will suffer. In addition, we recognize services revenue ratably over the term of the relevant service period, which is usually one to three years. As a result, much of the revenue we report each quarter is the recognition of deferred revenue from services contracts entered into during previous quarters. Consequently, a decline in new or renewal services contracts in any one quarter will not be fully reflected in revenue in that quarter, but will negatively affect our revenue in future quarters. Accordingly, the effect of significant downturns in new or renewal sales of our services would not be reflected in full in our results of operations until future periods.

If we are unable to increase sales to large customers, our results of operations may suffer.

We continuously seek to increase sales of our products to large enterprises, managed security service providers ("MSSPs"), cloud hosting providers and government entities. Sales to large enterprises, MSSPs, cloud hosting providers and government entities involve risks that may not be present, or are present to a lesser extent, in sales to small to mid-sized entities. These risks include:

- preexisting relationships with larger, entrenched providers of security solutions who have access to key decision makers within the organization and who also have the ability to bundle competing products with a broader product offering;
- increased purchasing power and leverage held by large customers in negotiating contractual arrangements with us;
- more stringent requirements in our support service contracts, including stricter support response times, and increased penalties for any failure to meet support requirements; and
- longer sales cycles, including lengthening of sales cycles due to competitive pressures or the evaluation by customers of both our cloud security solutions from Incapsula and our on-premise products as potential alternatives, and the associated risk that substantial time and resources may be spent on a potential customer who elects not to purchase our products and services.

In addition, product purchases by large enterprises, MSSPs, cloud hosting providers and government entities are frequently subject to budget constraints, multiple approvals, and unplanned administrative, processing and other delays. Further, large enterprises, MSSPs, cloud hosting providers and government entities typically have longer implementation cycles; require greater product functionality and scalability and a broader range of services; demand that vendors take on a larger share of risks; sometimes require acceptance provisions that can lead to a delay in revenue recognition; and expect greater payment flexibility from vendors. Additionally, the ongoing increase in the number of security vendors competing for these entities' business, who in some cases use overlapping or confusing messaging, may combine with these factors to extend the sales cycles for our products and services. All these factors can add risk to doing business with these customers. If our sales expectations for large customers do not materialize in a particular quarter or at all, then our business, financial condition and results of operations could be materially and adversely affected.

If our existing and potential customers migrate to hosted, cloud-based data centers that do not deploy our products, our revenue could suffer.

The majority of our current sales are made through a model in which our channel partners sell our cyber security solutions to large enterprise customers that operate their own data centers and have the ability to choose the cyber

security solutions and configurations to fit their environment. If our large enterprise customers and potential customers choose to outsource the hosting of their data centers to large, multi-tenancy hosting providers like Rackspace Hosting, Inc., Amazon Web Services ("AWS") and Savvis, Inc. (dba CenturyLink Technology Solutions), they may not be able to choose what cyber security solutions are deployed in these hosted environments, and our current sales model may not be effective. Although we work with large hosting services providers like Rackspace Hosting, Inc., AWS and Savvis, Inc., to integrate our cyber security solutions into their hosting environments so that our solutions may be offered to their hosting customers, we cannot guarantee that all such hosting service providers will adopt our solutions, offer them as a choice to their customers or promote our solutions over those of our competitors. Even if these large hosting services providers integrate our cyber security solutions into their hosting environments and promote our solutions, they may be able to negotiate larger discounts than individual enterprise customers and, consequently, the average selling price of our products may decrease and our revenue would suffer. Alternatively, they may offer services based on our competitors' products at lower cost or bundled with other services that we do not offer, and their customers may choose those services even if they would otherwise choose our products if making a decision on a stand-alone basis.

We are exposed to fluctuations in currency exchange rates, which could negatively affect our financial condition and results of operations.

Our functional and reporting currency is the U.S. dollar and we generate a majority of our revenue in U.S. dollars. However, in fiscal year 2016, fiscal year 2017 and the nine months ended September 30, 2018, we incurred approximately 38%, 32% and 35%, respectively, of our expenses outside of the United States in foreign currencies, primarily the Israeli shekel, principally with respect to salaries and related personnel expenses associated with our Israeli operations. The exchange rate between the U.S. dollar and foreign currencies has fluctuated substantially in recent years and may continue to fluctuate substantially in the future. We expect that a majority of our revenue will continue to be generated in U.S. dollars for the foreseeable future and that a significant portion of our expenses, including personnel costs, as well as capital and operating expenditures, will continue to be denominated in Israeli shekels. Our results of operations may be adversely affected by foreign exchange fluctuations.

We use forward foreign exchange contracts to hedge or mitigate the effect of changes in foreign exchange rates on our operating expenses denominated in certain foreign currencies. However, this strategy cannot eliminate our exposure to foreign exchange rate fluctuations and involves costs and risks of its own, such as cash expenditures, ongoing management time and expertise, external costs to implement the strategy and potential accounting implications. Additionally, our hedging activities may contribute to increased losses as a result of volatility in foreign currency markets.

Assertions by third parties of infringement or other violations by us of their intellectual property rights could result in significant costs and substantially harm our business and operating results.

Patent and other intellectual property disputes are common in the IT security industry. Some companies in the IT security industry, including some of our competitors, own large numbers of patents, copyrights, trademarks and trade secrets, which they may use to assert claims against us. This disparity between our patent portfolio and the patent portfolios of our most significant competitors may increase the risk that they may sue us for patent infringement and may limit our ability to counterclaim for patent infringement or settle through patent cross-licenses. In addition, there are patent holding companies or other patent owners who are solely or primarily in the business of building portfolios of patents and asserting them against operating companies, often with little merit, and who have no relevant product revenue so that potential assertions of our patents (and potential patents) against such companies may provide little or no deterrence. Third parties have asserted and may in the future assert claims of infringement, misappropriation or other violations of intellectual property rights against us. For example, in May 2010, F5 Networks, Inc., an IT infrastructure company that competes with us in the web application firewall market, filed a lawsuit against us alleging patent infringement. In September 2010, we filed a counterclaim alleging patent infringement by F5 Networks, Inc. In February 2011, we entered into a settlement and license agreement with F5 Networks, Inc., which dismissed the litigation. Third parties may also assert such claims against our customers or channel partners whom we typically indemnify against claims that our products infringe, misappropriate or otherwise violate the intellectual property rights of third parties. As the numbers of products and competitors in our market increase and overlaps occur, claims of infringement, misappropriation and other violations of intellectual property rights may increase. Also, to the extent we hire personnel from competitors, we may be subject to allegations that they have been improperly solicited by us or have divulged their prior employers' proprietary or other confidential information to Imperva.

We cannot assure you that we are not infringing or otherwise violating any third-party intellectual property rights. Further, any claim of infringement, misappropriation or other violation of intellectual property rights by a third party, even those without merit, could be asserted against us, cause us to incur substantial costs defending against the claim and could distract our management from our business. An adverse outcome of an IP dispute may require us to pay substantial damages, including treble damages, if we are found to have willfully infringed a third party's patents, copyrights, or trade secrets; cease making, licensing or using solutions that are alleged to infringe or misappropriate the intellectual property of others; expend additional development resources to attempt to redesign our products or services or otherwise to develop non-infringing technology, which may not be successful; enter into potentially

unfavorable royalty or license agreements in order to obtain the right to use necessary technologies or intellectual property rights; and indemnify our customers and partners. Royalty or licensing agreements, if required or desirable, may be unavailable on terms acceptable to us, or at all, or may require significant royalty payments and other expenditures. In addition, some licenses may be non-exclusive, and therefore our competitors may have access to the same technology licensed to us. Any of these events could seriously harm our business, financial condition and results of operations.

We rely on the availability of licenses to third-party software and other intellectual property, the loss of which could increase our costs and delay software shipments.

Many of our products and services include software or other intellectual property licensed from third parties, and we also use software and other intellectual property licensed from third parties in our business. This exposes us to risks over which we may have little or no control. For example, a licensor may have errors or defects in its products that harm our business, may have difficulties keeping up with technological changes or may stop supporting the software or other intellectual property that it licenses to us. Also, it will be necessary in the future to renew licenses, expand the scope of existing licenses or seek new licenses, relating to various aspects

of these products and services, or otherwise relating to our business, which may result in increased license fees. In addition, a direct or indirect licensor may assert that we or our customers are in breach of the terms of a license, which could, among other things, give such licensor the right to terminate a license or seek damages from us, or both. Moreover, the inclusion in our products and services of software or other intellectual property licensed from third parties on a nonexclusive basis could limit our ability to differentiate our products from those of our competitors.

Licensed software may not continue to be available on commercially reasonable terms, or at all. While we believe that there are currently adequate replacements for third-party software, any loss of the right to use any of this software could result in delays in producing or delivering our software until equivalent technology is identified and integrated, which delays could harm our business. Our business would be disrupted if any of the software we license from others or functional equivalents of this software were either no longer available to us or no longer offered to us on commercially reasonable terms. In either case, we would be required to either redesign our products to function with software available from other parties or to develop these components ourselves, which would result in increased costs and could result in delays in our product shipments and the release of new product offerings. Furthermore, we might be forced to limit the features available in our current or future products. If we fail to maintain or renegotiate any of these software licenses, we could face significant delays and diversion of resources in attempting to license and integrate a functional equivalent of the software. Any of these events could have a material adverse effect on our business, financial condition and results of operations.

Our products contain “open source” software, and any failure to comply with the terms of one or more of these open source licenses could negatively affect our business.

Certain of our products are distributed with software licensed under “open source” licenses. Some of these licenses contain requirements that we make available source code for modifications or derivative works we create based upon the open source software, and that we license these modifications or derivative works under the terms of a particular open source license or subject to certain license requirements. If we combine our proprietary software with open source software in a certain manner, we could, under certain provisions of the open source licenses, be required to release the source code of our proprietary software. In addition to risks related to license requirements, usage of open source software can subject us to greater risks than use of third-party commercial software, as licensors of open source software generally do not provide warranties or any indemnification for infringement of third party intellectual property rights. We have established processes to help alleviate these risks, including a review process for screening requests from our development organization for the use of open source software, but we cannot be sure that all open source software is submitted for approval prior to use in our products. In addition, open source license terms may be ambiguous and many of the risks associated with use of open source software cannot be eliminated, and could, if not properly addressed, negatively affect our business. If we were found to have inappropriately used open source software, we might be required to re-engineer our products, to release proprietary source code, to discontinue the sale of our products in the event re-engineering could not be accomplished on a timely basis or to take other remedial action that may divert resources away from our development efforts, any of which could adversely affect our business, operating results and financial condition. Disclosing the source code of our proprietary software could make it easier for malicious third parties to discover vulnerabilities in our cyber security products and allow our competitors to create similar products with decreased development effort and time. Any of these events could have a material adverse effect on our reputation, business, financial condition and results of operations.

Failure to protect our proprietary technology and intellectual property rights could substantially harm our business and operating results.

Our success depends, in part, on our ability to protect proprietary methods and technologies that we develop under the intellectual property laws of the United States and other countries, so that we can prevent others from using our inventions and proprietary information. We attempt to protect our intellectual property under patent, trademark, copyright and trade secret laws, and through a combination of confidentiality procedures, contractual provisions and other methods, all of which offer only limited protection. If we fail to protect our intellectual property rights

adequately, our competitors might gain access to our technology, and our business might be harmed. In addition, defending our intellectual property rights might entail significant expenses. Any of our patents, copyrights, trademarks or other intellectual property rights may be challenged by others or invalidated through administrative process or litigation. As of September 30, 2018, Imperva and its subsidiaries had 46 issued patents, 19 patent applications pending in the United States and 2 issued patents in Canada. Our issued patents, which are limited in number compared to some of our competitors, may not provide us with any competitive advantages or may be challenged by third parties, and our patent applications may never be granted at all. Additionally, the process of obtaining patent protection is expensive and time-consuming, and we may not be able to prosecute all necessary or desirable patent applications at a reasonable cost or in a timely manner. Further, for strategic and other reasons we may choose not to seek patent protection for certain innovations and may choose not to pursue patent protection in certain jurisdictions. Even if issued, there can be no assurance that our patents will adequately protect our intellectual property, as the legal standards relating to the validity, enforceability and scope of protection of patent and other intellectual property rights are uncertain.

Any patents that are issued may subsequently be invalidated or otherwise limited, enabling other companies to better develop products that compete with ours, which could adversely affect our competitive business position, business prospects and financial condition. In addition, issuance of a patent does not guarantee that we have a right to practice the patented invention. Patent applications in the United States are typically not published until 18 months after filing, or in some cases not at all, and publications of discoveries in industry-related literature lag behind actual discoveries. We cannot be certain that we were the first to make the inventions claimed in our issued patents or pending patent applications or otherwise used in our products, that we were the first to file for protection in our patent applications, or that third parties do not have blocking patents that could be used to prevent us from marketing or practicing our patented products or technology. Effective patent, trademark, copyright and trade secret protection may not be available to us in every country in which our products and services are available. The laws of some foreign countries may not be as protective of intellectual property rights as those in the United States, and mechanisms for enforcement of intellectual property rights may be inadequate. Accordingly, despite our efforts, we may be unable to prevent third parties from infringing upon or misappropriating our intellectual property.

We might be required to spend significant resources to monitor and protect our intellectual property rights. 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, which may adversely affect our business, operating results and financial condition.

We may become subject to claims for remuneration or royalties for assigned service invention rights by our Israeli employees, which could result in litigation and adversely affect our business.

We have entered into assignment of invention agreements with our Israeli employees pursuant to which such individuals agree to assign to us all rights to any inventions created in the scope of their employment or engagement with us. A significant portion of our intellectual property has been developed by our Israeli employees in the course of their employment for us. Under the Israeli Patents Law, 5727-1967 (the “Patents Law”), inventions conceived by an employee during the scope of his or her employment with a company are regarded as “service inventions,” which belong to the employer, absent a specific agreement between the employee and employer giving the employee service invention rights. The Patents Law also provides that if there is no such agreement between an employer and an employee, the Israeli Compensation and Royalties Committee (the “Committee”), a body constituted under the Patents Law, shall determine whether the employee is entitled to remuneration for his or her inventions. The Committee has previously held that employees may be entitled to remuneration for intellectual property that they develop during their service for a company despite their explicit waiver of such right. In a recent decision, however, the Committee overturned its position and upheld that an employee’s waiver of his right to remuneration is valid and binding. The plaintiff in this last case filed a petition with the Israeli Supreme Court requesting to remand the case to the Committee for a second review, but the Israeli Supreme Court decided on July 8, 2015 that the Committee acted within its administrative authority and that it would not intervene in the Committee’s decision. Even though the decision still stands, the Committee’s inconsistency raises doubt as to the outcome in different sets of circumstances. Thus, although our Israeli employees have agreed to assign to us service invention rights, we may face claims demanding remuneration in consideration for assigned inventions. As a consequence of such claims, we could be required to pay additional remuneration or royalties to our current and/or former Israeli employees, or be forced to litigate such claims, which could negatively affect our business.

Confidentiality agreements with partners, employees, consultants and others may not adequately prevent disclosure of trade secrets and other proprietary information.

In order to protect our proprietary technology, processes and methods, we rely in part on confidentiality agreements and other restrictions with our customers, partners, employees, consultants and others. These agreements may not effectively prevent disclosure of confidential information and may not provide an adequate remedy in the event of unauthorized disclosure of confidential information. Despite our efforts to protect our proprietary technology,

processes and methods, unauthorized parties may attempt to misappropriate, reverse engineer or otherwise obtain and use them. We may be unable to determine the extent of any unauthorized use or infringement of our products, technologies or intellectual property rights. In addition, others may independently develop identical or substantially similar technology and in these cases we would not be able to assert any trade secret rights against those parties. Moreover, policing unauthorized use of our technologies, products and intellectual property is difficult, expensive and time-consuming, particularly in foreign countries where the laws may not be as protective of intellectual property rights as those in the United States and where mechanisms for enforcement of intellectual property rights may be weak. Costly and time-consuming litigation could be necessary to enforce and determine the scope of our proprietary rights, and failure to obtain or maintain trade secret protection could adversely affect our competitive business position.

We are subject to governmental export and import controls that could subject us to liability or impair our ability to compete in international markets.

Our business activities are subject to various restrictions under U.S. export controls and trade and economic sanctions laws, including the U.S. Commerce Department's Export Administration Regulations and economic and trade sanctions regulations maintained by the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC"). If we fail to comply with these laws and regulations, we could be subject to civil or criminal penalties and reputational harm. U.S. export control laws and economic sanctions laws also prohibit certain transactions with U.S. embargoed or sanctioned countries, governments, persons and entities.

Many of our products incorporate encryption technology and may be exported outside the U.S. only if we obtain an export license or qualify for an export license exception. Compliance with applicable regulatory requirements regarding the export of our products may prevent our customers with international operations from deploying our products throughout their global systems or, in some cases, prevent the export of our products to some countries altogether. Further, various countries regulate the import of encryption technology and appliance-based products and have enacted laws that could limit our ability to distribute products, could create delays in the introduction of our products in those countries or could limit our customers' ability to implement our products in those countries.

U.S. export control laws and economic sanctions prohibit the shipment of certain products to U.S. embargoed or sanctioned countries, governments and persons. While we and our channel partners take precautions to prevent our products from being shipped to, downloaded or accessed by U.S. sanctions targets, our products could be shipped to, downloaded or accessed by persons located in countries that are the subject of U.S. embargoes despite our efforts. Any such shipment or access could have negative consequences, including government investigations, penalties and reputational harm. For example, in 2015, we discovered that some of our free downloadable software evaluation products may have been downloaded by a limited number of persons located in countries that are the subject of U.S. embargoes. We terminated the unauthorized accounts, filed an initial disclosure with the U.S. Commerce Department's Bureau of Industry and Security ("BIS") and with OFAC and filed final reports with BIS and OFAC on September 2, 2015 and September 22, 2015, respectively. We have implemented new screening measures designed to prevent users in embargoed countries and prohibited persons from purchasing, downloading or accessing our free downloadable evaluation software or other products or services. OFAC issued a cautionary letter on October 14, 2015 as a final enforcement response to the apparent violations and did not impose any monetary penalties. BIS issued a warning letter on October 5, 2016 in response to our voluntary self-disclosure and closed the matter, having determined not to take any further action. Even though we take precautions to prevent transactions with U.S. sanctions targets, any such precautions, or any new precautions we may implement in the future, may be ineffective. As a result, there is risk that in the future we could provide our products to or permit our products to be downloaded or accessed by such targets despite these precautions. This could result in negative consequences to us, including government investigations, penalties and reputational harm.

In the future, there may be changes in our products or changes in export and import regulations or economic sanctions. Similarly, there may be shifts in the enforcement or scope of existing regulations or restrictions or changes in the countries, governments, persons or technologies targeted by such regulations and restrictions. Such changes and shifts may create delays in the introduction and sale of our products in international markets, could result in decreased use of our products or, in some cases, prevent the sale of our products to certain countries, governments or persons altogether, including by current customers or potential customers. Any such limitation, delay, restriction or reduction could adversely affect our business, financial condition, results of operations and prospects.

Conditions in Israel may limit our ability to develop and sell our products. This could result in a decline in revenue.

Our principal research and development facilities are located in Israel. Since the establishment of the State of Israel in 1948, a number of armed conflicts have taken place between Israel and its neighboring countries, as well as incidents of civil unrest, and a number of state and non-state actors have publicly committed to its destruction. Political,

economic and military conditions in Israel could directly affect our operations. We could be adversely affected by any major hostilities involving Israel, including acts of terrorism or any other hostilities involving or threatening Israel, the interruption or curtailment of trade between Israel and its trading partners, a significant increase in inflation or a significant downturn in the economic or financial condition of Israel. Any on-going or future violence between Israel and the Palestinians, including a resumption of the conflict in Gaza, armed conflicts, terrorist activities, tension along the Israeli borders or with other countries in the region, including Iran, or political instability in the region could disrupt international trading activities in Israel and may materially and negatively affect our business and could harm our results of operations.

Certain countries, as well as certain companies and organizations, continue to participate in a boycott of Israeli companies, companies with large Israeli operations and others doing business with Israel and Israeli companies. In addition, such boycott, restrictive laws, policies or practices may change over time in unpredictable ways, and could, individually or in the aggregate, have a material adverse effect on our business in the future.

Some of our employees in Israel are obligated to perform annual military reserve duty in the Israel Defense Forces, depending on their age and position in the armed forces. Furthermore, they may be called to active reserve duty at any time under emergency circumstances for extended periods of time. For example, in 2017, approximately 70 of our employees in Israel were called for active reserve duty, each serving for an average of nine days. Our operations could be disrupted by the absence of one or more of our executive officers or key employees for a significant period due to military service, and any significant disruption in our operations could harm our business.

Our internal network system and website may be subject to intentional disruption that could adversely impact our reputation and future sales.

Because we are a leading provider of cyber security products, hackers and others may try to access our data or compromise our systems. Similarly, experienced computer programmers may attempt to penetrate our network security or the security of our website and cause interruptions of our services. Because the techniques used by hackers to access or sabotage networks change frequently and may not be recognized until launched against a target, we may be unable to anticipate these techniques. The theft and/or unauthorized use or publication of our trade secrets and other confidential business information as a result of such an event could adversely affect our competitive position, reputation, brand and future sales of our products, and could impair our ability to operate our business, including our ability to provide subscription or maintenance and support services to our customers. We could suffer monetary and other losses and reputational harm in the event of such incidents.

Outages, interruptions or delays in hosting services could impair the delivery of our cloud-based security services and harm our business.

We operate infrastructure that supports our Attack Analytics, ThreatRadar and Security Operations Center services and use third party hosting facilities for certain Incapsula, Attack Analytics and ThreatRadar services. Despite precautions taken within our own internal network and at these third party facilities, the occurrence of a natural disaster or an act of terrorism or other unanticipated problems could result in lengthy interruptions in our services.

The cloud-based security services that we provide through our subsidiary, Incapsula, are operated from a network of third party facilities that host the software and systems that operate these security services. Any damage to, or failure of, our internal systems or systems at third party hosting facilities could result in outages or interruptions in our cloud-based services. Outages or interruptions in our cloud-based security services may cause our customers and potential customers to believe our cloud-based security services are unreliable or suffer from perceived vulnerabilities, cause us to issue credits or pay penalties, cause customers to terminate their subscriptions and adversely affect our renewal rates and our ability to attract new customers, ultimately harming our business and revenue. Our Incapsula service has experienced outages in the past and we may continue to experience such outages in the future.

Changes in our provision for income taxes or adverse outcomes resulting from examination of our income tax returns could adversely affect our results.

We are subject to income taxation in the United States and numerous foreign jurisdictions, including Israel. Determining our provision for income taxes requires significant management judgment. Our provision for income taxes is subject to volatility and many factors could adversely impact it. Such factors include, among others, changes to our operating or holding structure, changes in the amounts of earnings in jurisdictions with differing statutory tax rates, changes in the valuation of deferred tax assets and liabilities, and changes in tax laws. In particular, changes to tax laws applicable to corporate multinationals in the countries in which we do business could adversely affect our effective tax rates, cause us to change the way in which we structure our business or result in other costs to us.

On December 22, 2017, the U.S. Tax Cuts and Jobs Act of 2017 (the "Tax Act") was enacted. The Tax Act represents a significant change to the U.S. federal tax code. It lowers the U.S. statutory tax rate from 35% to 21% for years after 2017, and also includes a number of provisions that could adversely impact our U.S. federal income tax position in a

reporting period, including the limitation of the utilization of net operating losses generated after 2018 to 80 percent of taxable income but allow for indefinite carryforward of these net operating losses, and a minimum tax on certain foreign earnings in excess of 10 percent of the foreign subsidiaries' tangible assets. We have remeasured our U.S. deferred tax assets as of December 31, 2017 to reflect the reduced rate that will apply in future periods when the deferred tax assets reverse, offset by a change in valuation allowance, resulting in a net impact of an approximately $0.2 million tax benefit. Our final determination of the Tax Act's impact on deferred tax assets and the related valuation allowance requirements may differ from our estimates due to, among other factors, changes in interpretations of the Tax Act, our analysis of the Tax Act, or any updates or changes to estimates that we have utilized to calculate the transition impacts, including impacts from changes to current year earnings estimates and assertions. In addition, any further changes to tax laws applicable to corporate multinationals in the countries in which we do business could adversely affect our effective tax rates, cause us to change the way in which we structure our business or result in other costs to us.

In addition, in April 2018, the Israeli Supreme Court decided on the appeals by Kontera Technologies Ltd. and Finisar Israel Ltd. As a result of the court's ruling, Israeli subsidiaries implementing a cost-plus arrangement must include employee stock-based compensation in the cost base, notwithstanding that such expenses were specifically disallowed as a tax deduction for Israeli tax purposes. As a result of the decision, we took an additional tax reserve of approximately $17.2 million in taxes and $2.1 million in interest. Both amounts are recorded under income tax expense in the condensed consolidated statement of operations. This adjustment represents a significant change in the estimated tax exposure for our Israeli subsidiaries.

Our determinations regarding income tax recognition and measurement attributes are subject to significant judgment, as set forth in ASC 740-10 on Income Taxes. In addition, ASC 740-10 applies to all income tax positions, including the potential recovery of previously paid taxes, which if settled unfavorably could adversely impact our provision for income taxes or additional paid-in capital. We are subject to the continuous examination of our income tax returns by the U.S. Internal Revenue Service and other tax authorities. We are currently under audit by the Israeli Tax Authority. The audit includes the review of our intercompany charges, cross-jurisdictional transfer pricing, determinations regarding the inclusion of stock-based compensation expense as part of a cost-plus arrangement and taxes owed on the purchase and sale of Skyfence intellectual property and related assets in 2017. While we regularly assess the likely outcomes of these examinations to determine the adequacy of our provision for income taxes, there can be no assurance that the outcomes of such examinations will not have a material impact on our operating results and cash flows.

Our ability to utilize net operating loss carryforwards may be subject to limitations and may result in increased future tax liability to us.

Our ability to utilize net operating loss carryforwards to offset our future tax liability would be limited if we were to undergo an "ownership change" within the meaning of Section 382 of the Internal Revenue Code. Generally, a change of more than 50% in the ownership of a corporation's stock, by value, over a three-year period constitutes an ownership change for U.S. federal and applicable state income tax purposes. In the event we undergo an ownership change under Section 382, if we earn net taxable income, our ability to use our pre-change net operating loss carryforwards to offset U.S. federal taxable income may become subject to limitations, which could potentially result in increased future tax liability to us.

Our business is subject to the risks of earthquakes, fire, power outages, floods and other catastrophic events, and to interruption by manmade events such as terrorist attacks.

A significant natural disaster, such as an earthquake, fire or a flood, or a significant power outage could have a material adverse impact on our business, financial condition and results of operations. Our corporate headquarters are located in the San Francisco Bay Area, a region known for seismic activity, on land reclaimed from the bay that is susceptible to high liquefaction risk in the event of an earthquake. In addition, natural disasters could affect our manufacturing vendors or logistics providers' ability to perform services such as manufacturing products on a timely basis and assisting with shipments on a timely basis. In the event our service providers' information technology systems or manufacturing or logistics abilities are hindered by any of the events discussed above, shipments could be delayed, resulting in missing financial targets, such as revenue and shipment targets, for a particular quarter. Further, if a natural disaster occurs in a region from which we derive a significant portion of our revenue, customers in that region may delay or forego purchases of our products, which may materially and adversely impact our results of operations for a particular period. In addition, acts of terrorism could cause disruptions in our business or the business of our manufacturer, logistics providers, partners, customers or the economy as a whole. Given our typical concentration of sales at each quarter end, any disruption in the business of our manufacturer, logistics providers, partners or customers that impacts sales at the end of our quarter could have a significant adverse impact on our quarterly results. All of the aforementioned risks may be augmented if the business continuity plans for us and our suppliers prove to be inadequate. To the extent that any of the above results in delays or cancellations of customer orders, or the delay in the manufacture, deployment or shipment of our products, our business, financial condition and

results of operations would be adversely affected.

Risks Related to Ownership of our Common Stock

If we fail to maintain an effective system of disclosure controls and procedures and internal controls over financial reporting, our ability to produce accurate financial statements or comply with applicable regulations could be impaired.

As a public company, we are subject to the reporting requirements of the Exchange Act, the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act"), and the rules and regulations of the Nasdaq Stock Market LLC. We expect that the requirements of these rules and regulations will continue to increase our legal, accounting and financial compliance costs, make some activities more difficult, time-consuming and costly and place strains on our personnel, systems and resources.

The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal control over financial reporting. We are continuing to develop and refine our disclosure controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file with the SEC is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Our current controls and any new controls that we develop may become inadequate because of changes in conditions, and the degree of compliance with the policies or procedures may deteriorate. In addition, weaknesses in our internal controls over financial reporting may be discovered in the future.

Our filings with the SEC are subject to periodic review by the SEC, and our auditors are subject to periodic inspection by the Public Company Accounting Oversight Board. Any failure to maintain effective controls over financial reporting, any difficulties encountered in the implementation of additional controls or the improvement of existing controls, or any issues that emerge as a result of regulatory review, could harm our operating results or cause us to fail to meet our reporting obligations and may result in a revision or restatement of our prior period financial statements. Any failure to maintain effective internal controls also could adversely affect the results of periodic management evaluations and annual independent registered public accounting firm attestation reports regarding the effectiveness of our internal control over financial reporting that we are required to include in our annual reports filed with the SEC under Section 404 of the Sarbanes-Oxley Act. Ineffective disclosure controls and procedures and internal control over financial reporting could also cause investors to lose confidence in our reported financial and other information, which would likely have a negative effect on the trading price of our common stock.

For example, in connection with the review of our interim condensed consolidated financial statements in our Form 10-Q filed with the SEC on November 7, 2014, management, including our then-current chief executive officer and chief financial officer, assessed the effectiveness of our disclosure controls and procedures as of September 30, 2014. Based on that assessment, management concluded that our disclosure controls and procedures were not effective as of September 30, 2014, because of a material weakness in internal control over financial reporting related to insufficient oversight and review controls to ensure the proper determination of stock-based compensation expense for certain complex equity awards that were not issued in the ordinary course. While these control deficiencies were remediated, we continue to identify risks and make improvements to our internal controls and we cannot assure you that additional material weaknesses in our internal control over financial reporting will not be identified in the future.

In order to maintain and improve the effectiveness of our disclosure controls and procedures and internal control over financial reporting, we have expended significant resources, and anticipate that we will continue to add personnel and provide significant management oversight, which involve substantial accounting-related costs. Any failure to maintain the adequacy of our internal controls, or consequent inability to produce accurate financial statements on a timely basis, could increase our operating costs and could materially impair our ability to operate our business. In the event that we are not able to continue to demonstrate compliance with Section 404 of the Sarbanes-Oxley Act in a timely manner, that our internal controls are perceived as inadequate or that we are unable to produce timely or accurate financial statements, investors may lose confidence in our operating results and our stock price could decline. In addition, if we are unable to continue to meet these requirements, we may not be able to remain listed on the Nasdaq Global Select Market.

We also have implemented elements of a disaster recovery/business continuity plan for our accounting and related information technology systems but we have not yet implemented a complete disaster recovery/business continuity plan that covers all of our operations. If the elements that we have developed and plan to develop in the future prove inadequate in the circumstances of a particular disaster or other business continuity event, our ability to maintain timely accounting and reporting may be materially impaired.

Market volatility may affect our stock price and the value of your investment

The trading prices of the securities of technology companies generally, and of our stock in particular, have been highly volatile. The market price of our common stock may fluctuate significantly in response to a number of factors, most of which we cannot predict or control, including:

- announcements of new products, services or technologies, commercial relationships, acquisitions, dispositions, strategic partnerships, joint ventures, capital commitments or other events by us or our competitors;
- fluctuations in operating performance and in stock market prices and trading volumes of securities of other technology companies generally, or those in our industry in particular;
- general market conditions and overall price and volume fluctuations in U.S. equity markets;

- actual or anticipated variations in our operating results, or the operating results of our competitors;
- the financial and other projections we may provide to the public, any changes in these projections or our failure to meet these projections or changes in our financial guidance or securities analysts' estimates of our financial performance;
- failure of securities analysts to maintain coverage of us, changes in financial or other estimates by any securities analysts who follow us, or our failure to meet these estimates or the expectations of our investors;
- ratings or other changes by any securities analysts who follow our company or our industry;
- announcements of restructurings, reductions in force, departure of senior management or key employees and/or consolidation of operations;

- sales or purchases of large blocks of our common stock, including by our executive officers, directors, significant stockholders and activist stockholders;
- rumors and market speculation involving Imperva or other companies in our industry, particularly with respect to strategic transactions; and
- lawsuits threatened or filed against us and changing legal or regulatory developments in the United States and other countries.

In addition, the stock market in general, and the Nasdaq Stock Market in particular, have experienced substantial price and volume volatility that is often seemingly unrelated to the operating performance of particular companies. These broad market fluctuations or factors affecting us more specifically may cause the trading price of our common stock to decline. In the past, securities class action litigation has often been brought against a company after a period of volatility in the market price of its common stock.

We face risks related to securities litigation that could result in significant legal expenses and settlement or damage awards.

We have been and may in the future become subject to claims and litigation alleging violations of the securities laws or similar claims, which could harm our business and require us to incur significant costs. For example, in August 2017, two purported class action lawsuits were filed against us alleging background check law violations and wage and hour law violations, among other allegations. Prior to that, in April 2014, a purported stockholder class action lawsuit was filed against us and certain of our officers alleging that we made false and misleading statements and purporting to assert claims for violations of the federal securities laws, and seeking unspecified compensatory damages and other relief. While we settled the federal securities laws litigation in January 2018, and as described further in Part II, Item 1 (Legal Proceedings), we recently reached an agreement in principle to settle the August 2017 claims, future litigation of this type may require significant attention from management and could result in significant legal expenses, settlement costs or damage awards that could have a material impact on our financial position, results of operations and cash flows.

If securities or industry analysts do not publish research or publish inaccurate or unfavorable research about our business, our stock price and trading volume could decline.

The trading market for our common stock will depend in part on the research and reports that securities or industry analysts publish about us or our industry. If we do not establish and maintain adequate research coverage or if one or more of the analysts who covers us downgrades our stock or publishes inaccurate or unfavorable research about our business, our stock price would likely decline. If one or more of these analysts ceases coverage of our company or fails to publish reports on us regularly, demand for our stock could decrease, which could cause our stock price and trading volume to decline.

We do not intend to pay dividends on our common stock so any returns will be limited to the value of our stock.

We have never declared or paid any cash dividend on our common stock. We currently anticipate that we will retain future earnings for the development, operation and expansion of our business and do not anticipate declaring or paying any cash dividends for the foreseeable future. Any return to stockholders will therefore be limited to the value of their stock.

Anti-takeover provisions in our charter documents and under Delaware law could make an acquisition of us, which may be beneficial to our stockholders, more difficult and may prevent attempts by our stockholders to replace or remove our current management.

Provisions in our restated certificate of incorporation and amended and restated bylaws may delay or prevent an acquisition of us or a change in our management. These provisions include:

- authorizing “blank check” preferred stock, which could be issued by the board without stockholder approval and may contain voting, liquidation, dividend and other rights superior to our common stock, which would increase the number of outstanding shares and could thwart a takeover attempt;
- a classified board of directors whose members can be dismissed only for cause;
- the prohibition on actions by written consent of our stockholders;
- the limitation on who may call a special meeting of stockholders;

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- the establishment of stock ownership and advance notice requirements for stockholders who intend to submit proposals to be acted upon at stockholder meetings, including nominations of persons for election to our board of directors; and
- the requirement that we must obtain the affirmative vote of at least 75% of all outstanding shares of capital stock to approve amendments to certain provisions of our certificate of incorporation.

In addition, because we are incorporated in Delaware, we are governed by the anti-takeover provisions of the Delaware General Corporation Law, which may discourage, delay or prevent a change in control by prohibiting us from engaging in a business combination with an interested stockholder for a period of three years after the person becomes an interested stockholder, even if a change of control would be beneficial to our existing stockholders. Although we believe these provisions collectively provide for an opportunity to obtain greater value for stockholders by requiring potential acquirers to negotiate with our board of directors, they would apply even if an offer rejected by our board were considered beneficial by some stockholders. In addition, these provisions may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace members of our board of directors, which is responsible for appointing the members of our management.

We previously announced a review of strategic alternatives and our subsequent decision to remain a standalone company, which may result in lingering uncertainty about our prospects.

On August 4, 2016, we announced that we retained advisors to assist us in a comprehensive review of strategic alternatives and on November 3, 2016, we announced that we had concluded the review process. The process did not result in a transaction or any other specific strategic action, but did result in a restructuring plan that was also announced. These announcements may result in a perception from time to time that there is uncertainty about our prospects as a standalone entity, and may lead to rumors of instability, irrespective of the actual circumstances, which may be exploited by our competitors, cause concern to our current or potential customers and partners, and make it more difficult to attract and retain qualified personnel. Such issues or perceptions may negatively impact our business, disrupt our operations and divert the attention of management and our employees, all of which could materially and adversely affect our operations and operating results. In addition, our stock price may experience periods of increased volatility as a result of prolonged rumors and speculation about our business.

We have concluded the review of strategic alternatives in November 2016, and are currently pursuing the Transaction with Thoma Bravo as discussed above. We remain subject to the uncertainties and risks relative to negative perceptions described above as well as specifically in relation to the Transaction.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Use of Proceeds from Public Offering of Common Stock

The Form S-1 Registration Statement (Registration No. 333-175008) relating to our initial public offering (“IPO”) was declared effective by the SEC on November 8, 2011. The net proceeds to us of our IPO after deducting $6.9 million of underwriters’ discounts and $5.8 million of offering expenses were $86.2 million. As disclosed in our Annual Report on Form 10-K for the year ended December 31, 2017 that was filed on February 23, 2018 (File No. 001-35338), we have used $29.4 million of the proceeds in connection with acquisitions. We used the remaining net IPO proceeds for our acquisition of Prevoty.

Unregistered Sales of Equity Securities

For the quarter ended September 30, 2018, we did not sell any unregistered securities.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

Exhibit Number	Exhibit Description
2.1	Agreement and Plan of Merger by and among Imperva, Inc., Pahlmeyer Acquisition Sub, Inc., Prevoty, Inc. and Fortis Advisors LLC, dated as of July 25, 2018 (incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed on July 26, 2018 (File No. 001-35338)).
2.2	Agreement and Plan of Merger, dated October 10, 2018, by and among Imperial Purchaser LLC, Imperial Merger Sub, Inc. and Imperva, Inc. (incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed on October 10, 2018 (File No. 001-35338)).
10.1	Amended and Restated 2018 Senior Management Bonus Plan, dated August 10, 2018 (incorporated by reference to Exhibit 99.2 to the Company's Current Report on Form 8-K filed on August 16, 2018 (File No. 001-35338)).
31.01	Certification of Principal Executive Officer Pursuant to Securities Exchange Act Rule 13a-14(a).
31.02	Certification of Principal Financial Officer Pursuant to Securities Exchange Act Rule 13a-14(a).
32.01*	Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350 and Securities Exchange Act Rule 13a-14(b).
32.02*	Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350 and Securities Exchange Act Rule 13a-14(b).
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Calculation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	XBRL Taxonomy Label Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.

* This certification is not deemed "filed" for purposes of Section 18 of the Securities Exchange Act, or otherwise subject to the liability of that section. Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent that Imperva, Inc. specifically incorporates it by reference.

SIGNATURES

Pursuant to the requirements 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.

Date: November 5, 2018	IMPERVA, INC.
	By: /s/ Christopher S. Hylen Christopher S. Hylen President and Chief Executive Officer (Principal Executive Officer)
Date: November 5, 2018	
	By: /s/ Mike Burns Mike Burns Chief Financial Officer (Principal Financial Officer)

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