

SALESFORCE COM INC  
Form 10-Q  
August 26, 2014  
Table of Contents

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

FORM 10-Q

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended July 31, 2014

OR

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

salesforce.com, inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of  
incorporation or organization)

The Landmark @ One Market, Suite 300  
San Francisco, California 94105

(Address of principal executive offices)

Telephone Number (415) 901-7000

(Registrant's telephone number, including area code)

94-3320693

(IRS Employer  
Identification No.)

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

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

As of July 31, 2014, there were approximately 619.0 million shares of the Registrant's Common Stock outstanding.

Table of Contents

INDEX

	Page No.
<u>PART I. FINANCIAL INFORMATION</u>	
Item 1. <u>Financial Statements:</u>	
<u>Condensed Consolidated Balance Sheets as of July 31, 2014 and January 31, 2014</u>	1
<u>Condensed Consolidated Statements of Operations for the three and six months ended July 31, 2014 and 2013</u>	2
<u>Condensed Consolidated Statements of Comprehensive Income (Loss) for the three and six months ended July 31, 2014 and 2013</u>	3
<u>Condensed Consolidated Statements of Cash Flows for the three and six months ended July 31, 2014 and 2013</u>	4
<u>Notes to Condensed Consolidated Financial Statements</u>	5
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	30
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	56
Item 4. <u>Controls and Procedures</u>	58
<u>PART II. OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	59
Item 1A. <u>Risk Factors</u>	60
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	73
Item 3. <u>Defaults Upon Senior Securities</u>	73
Item 4. <u>Mine Safety Disclosures</u>	73
Item 5. <u>Other Information</u>	73
Item 6. <u>Exhibits</u>	74

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

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Condensed Consolidated Balance Sheets

(in thousands)

	July 31, 2014 (unaudited)	January 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	\$774,725	\$781,635
Short-term marketable securities	69,850	57,139
Accounts receivable, net	834,323	1,360,837
Deferred commissions	169,247	171,461
Land and building improvements held for sale	160,181	0
Prepaid expenses and other current assets	296,361	309,180
Total current assets	2,304,687	2,680,252
Marketable securities, noncurrent	827,183	482,243
Property and equipment, net	1,189,930	1,240,746
Deferred commissions, noncurrent	141,260	153,459
Capitalized software, net	449,499	481,917
Goodwill	3,492,713	3,500,823
Other assets, net	604,556	613,490
Total assets	\$9,009,828	\$9,152,930
Liabilities, temporary equity and stockholders' equity		
Current liabilities:		
Accounts payable, accrued expenses and other liabilities	\$891,062	\$934,324
Deferred revenue	2,316,574	2,473,705
Convertible 0.75% senior notes, net	265,102	542,159
Term loan, current	30,000	30,000
Total current liabilities	3,502,738	3,980,188
Convertible 0.25% senior notes, net	1,058,737	1,046,930
Term loan, noncurrent	240,000	255,000
Deferred revenue, noncurrent	36,330	48,410
Other noncurrent liabilities	865,277	757,187
Total liabilities	5,703,082	6,087,715
Temporary equity	6,178	26,705
Stockholders' equity:		
Common stock	619	610
Additional paid-in capital	3,789,942	3,363,377
Accumulated other comprehensive income	11,163	17,680
Accumulated deficit	(501,156)	(343,157)
Total stockholders' equity	3,300,568	3,038,510
Total liabilities, temporary equity and stockholders' equity	\$9,009,828	\$9,152,930

See accompanying Notes.



Table of Contents

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Condensed Consolidated Statements of Operations

(in thousands, except per share data)

(unaudited)

	Three Months Ended		Six Months Ended	
	July 31,		July 31,	
	2014	2013	2014	2013
Revenues:				
Subscription and support	\$1,232,587	\$902,844	\$2,379,893	\$1,745,065
Professional services and other	85,964	54,250	165,430	104,662
Total revenues	1,318,551	957,094	2,545,323	1,849,727
Cost of revenues (1)(2):				
Subscription and support	218,918	160,908	427,865	314,458
Professional services and other	88,913	56,809	172,271	112,253
Total cost of revenues	307,831	217,717	600,136	426,711
Gross profit	1,010,720	739,377	1,945,187	1,423,016
Operating expenses (1)(2):				
Research and development	203,109	148,079	391,467	280,018
Marketing and sales	671,958	480,621	1,311,313	947,111
General and administrative	169,087	150,534	331,182	280,284
Total operating expenses	1,044,154	779,234	2,033,962	1,507,413
Loss from operations	(33,434 )	(39,857 )	(88,775 )	(84,397 )
Investment income	2,655	4,387	4,433	7,741
Interest expense	(18,314 )	(19,656 )	(38,673 )	(31,539 )
Other expense	(3,876 )	(1,678 )	(14,723 )	(2,552 )
Loss before benefit from (provision for) income taxes	(52,969 )	(56,804 )	(137,738 )	(110,747 )
Benefit from (provision for) income taxes (3)	(8,119 )	133,407	(20,261 )	119,629
Net income (loss)	\$(61,088 )	\$76,603	\$(157,999 )	\$8,882
Basic net income (loss) per share	\$(0.10 )	\$0.13	\$(0.26 )	\$0.02
Diluted net income (loss) per share	\$(0.10 )	\$0.12	\$(0.26 )	\$0.01
Shares used in computing basic net income (loss) per share	617,016	593,955	614,797	591,210
Shares used in computing diluted net income (loss) per share	617,016	624,656	614,797	623,865

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

	Three Months Ended July 31,		Six Months Ended July 31,	
	2014	2013	2014	2013
Cost of revenues	\$21,271	\$22,550	\$49,943	\$43,855
Marketing and sales	14,648	4,476	29,613	6,936

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

	Three Months Ended July 31,		Six Months Ended July 31,	
	2014	2013	2014	2013
Cost of revenues	\$12,977	\$9,981	\$24,787	\$20,659
Research and development	33,112	26,032	60,396	50,461
Marketing and sales	70,485	56,133	137,618	115,935

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General and administrative	25,837	18,330	50,702	38,150
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(3) The three and six months ended July 31, 2013 include a \$128.8 million tax benefit recorded during the three months ended July 31, 2013 as a result of the partial release of the Company's tax valuation allowance.

See accompanying Notes.

2

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Table of Contents

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Condensed Consolidated Statements of Comprehensive Income (Loss)

(in thousands)

(unaudited)

	Three Months Ended		Six Months Ended	
	July 31,		July 31,	
	2014	2013	2014	2013
Net income (loss)	\$ (61,088	) \$ 76,603	\$ (157,999	) \$ 8,882
Other comprehensive loss, before tax and net of reclassification adjustments:				
Foreign currency translation and other losses	(5,299	) (1,431	) (2,184	) (7,191
Unrealized gains (losses) on investments	1,164	117	(4,333	) 1,838
Other comprehensive loss, before tax	(4,135	) (1,314	) (6,517	) (5,353
Tax effect	0	(1,173	) 0	(545
Other comprehensive loss, net of tax	(4,135	) (2,487	) (6,517	) (5,898
Comprehensive income (loss)	\$ (65,223	) \$ 74,116	\$ (164,516	) \$ 2,984
See accompanying Notes.				

Table of Contents

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Condensed Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Three Months Ended		Six Months Ended	
	July 31,		July 31,	
	2014	2013	2014	2013
Operating activities:				
Net income (loss)	\$(61,088	) \$76,603	\$(157,999	) \$8,882
Adjustments to reconcile net income (loss) to net cash provided by operating activities:				
Depreciation and amortization	107,596	77,966	218,404	140,263
Amortization of debt discount and transaction costs	9,949	13,194	21,740	22,864
Loss on conversions of convertible senior notes	361	0	8,890	0
Amortization of deferred commissions	61,300	46,189	121,155	91,856
Expenses related to employee stock plans	142,411	110,476	273,503	225,205
Excess tax benefits from employee stock plans	6,815	1,278	(2,226	) (588
Changes in assets and liabilities, net of business combinations:				
Accounts receivable, net	(150,168	) (33,297	) 526,514	336,592
Deferred commissions	(65,846	) (45,347	) (106,742	) (62,830
Prepaid expenses and other current assets and other assets	23,636	(2,930	) 27,913	(9,280
Accounts payable, accrued expenses and other liabilities	142,638	(70,750	) (42,961	) (166,558
Deferred revenue	28,289	9,801	(169,211	) (120,034
Net cash provided by operating activities	245,893	183,183	718,980	466,372
Investing activities:				
Business combinations, net of cash acquired	0	(2,592,571	) 0	(2,614,732
Nonrefundable deposits received for land	1,000	0	31,000	0
Strategic investments	(18,807	) (3,698	) (35,053	) (8,814
Purchases of marketable securities	(284,928	) (56,458	) (535,464	) (320,745
Sales of marketable securities	71,073	893,910	150,385	1,005,650
Maturities of marketable securities	16,762	6,046	23,960	20,604
Capital expenditures	(71,576	) (102,549	) (131,674	) (156,559
Net cash used in investing activities	(286,476	) (1,855,320	) (496,846	) (2,074,596
Financing activities:				
Proceeds from borrowings on convertible senior notes, net	0	0	0	1,132,750
Proceeds from issuance of warrants	0	0	0	84,800
Purchase of convertible note hedge	0	0	0	(153,800
Proceeds from term loan, net	0	298,500	0	298,500
Proceeds from employee stock plans	61,429	40,195	135,224	106,719
Excess tax benefits from employee stock plans	(6,815	) (1,278	) 2,226	588
Payments on convertible senior notes	(13,692	) 0	(297,584	) 0
Principal payments on capital lease obligations	(40,341	) (12,108	) (50,935	) (20,607
Principal payments on term loan	(7,500	) 0	(15,000	) 0
Net cash provided by (used in) financing activities	(6,919	) 325,309	(226,069	) 1,448,950
Effect of exchange rate changes	(5,664	) (1,281	) (2,975	) (8,090
Net decrease in cash and cash equivalents	(53,166	) (1,348,109	) (6,910	) (167,364
Cash and cash equivalents, beginning of period	827,891	1,927,990	781,635	747,245



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Cash and cash equivalents, end of period	\$774,725	\$579,881	\$774,725	\$579,881
Supplemental cash flow disclosure:				
Cash paid during the period for:				
Interest	\$8,322	\$4,549	\$16,989	\$5,191
Income taxes, net of tax refunds	\$14,805	\$2,238	\$24,799	\$19,521
Non-cash financing and investing activities:				
Fixed assets acquired under capital leases	\$75,449	\$467,117	\$81,335	\$473,674
Building in progress - leased facility acquired under financing obligation	\$20,288	\$0	\$33,048	\$0
Fair value of equity awards assumed	\$0	\$41,676	\$0	\$41,676
See accompanying Notes.				

4

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Table of Contents

salesforce.com, inc.

Notes to Condensed Consolidated Financial Statements

1. Summary of Business and Significant Accounting Policies

Description of Business

Salesforce.com, inc. (the “Company”) is a provider of enterprise cloud computing services. The Company is dedicated to helping customers of all sizes and industries worldwide transform themselves into “customer companies” by empowering them to connect with their customers, partners, employees and products in entirely new ways. The Company provides customers with the solutions they need to build a next generation social front office with social and mobile cloud technologies.

Fiscal Year

The Company’s fiscal year ends on January 31. References to fiscal 2015, for example, refer to the fiscal year ending January 31, 2015.

Basis of Presentation

The accompanying condensed consolidated balance sheet as of July 31, 2014 and the condensed consolidated statements of operations, the condensed consolidated statements of comprehensive income (loss) and the condensed consolidated statements of cash flows for the three and six months ended July 31, 2014 and 2013, respectively, are unaudited. The condensed consolidated balance sheet data as of January 31, 2014 was derived from the audited consolidated financial statements which are included in the Company’s Form 10-K for the fiscal year ended January 31, 2014, which was filed with the Securities and Exchange Commission (the “SEC”) on March 5, 2014. The accompanying statements should be read in conjunction with the audited consolidated financial statements and related notes contained in the Company’s fiscal 2014 Form 10-K.

The accompanying condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“U.S. GAAP”) for interim financial information. Accordingly, they do not include all of the financial information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of the Company’s management, the unaudited condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements in the Form 10-K, and include all adjustments necessary for the fair presentation of the Company’s balance sheet as of July 31, 2014, and its results of operations, including its comprehensive loss, and its cash flows for the three and six months ended July 31, 2014 and 2013. All adjustments are of a normal recurring nature. The results for the three and six months ended July 31, 2014 are not necessarily indicative of the results to be expected for any subsequent quarter or for the fiscal year ending January 31, 2015.

Use of Estimates

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

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

- the best estimate of selling price of the deliverables included in multiple deliverable revenue arrangements,
- the fair value of assets acquired and liabilities assumed for business combinations,
- the recognition, measurement and valuation of current and deferred income taxes,
- the recognition and measurement of loss contingencies,
- the fair value of convertible notes,
- the fair value of stock awards issued and related forfeiture rates,
- the valuation of strategic investments and the determination of other-than-temporary impairments,
- the estimate of real estate sublease rental rates and market conditions, and
- the assessment of recoverability of long-lived assets (property and equipment, goodwill and identified intangibles).

Actual results could differ materially from those estimates.

Table of Contents

## Principles of Consolidation

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

## Segments

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

## Concentrations of Credit Risk and Significant Customers

The Company's financial instruments that are exposed to concentrations of credit risk consist primarily of cash and cash equivalents, marketable securities and trade accounts receivable. Although the Company deposits its cash with multiple financial institutions, its deposits, at times, may exceed federally insured limits. Collateral is not required for accounts receivable. The Company maintains an allowance for doubtful accounts receivable balances. The allowance is based upon historical loss patterns, the number of days that billings are past due and an evaluation of the potential risk of loss associated with delinquent accounts.

No customer accounted for more than five percent of accounts receivable at July 31, 2014 and January 31, 2014, respectively. No single customer accounted for five percent or more of total revenue during the three and six months ended July 31, 2014 and 2013.

## Geographic Locations

As of July 31, 2014 and January 31, 2014, assets located outside the Americas were 13 percent and 12 percent of total assets, respectively.

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

	Three Months Ended		Six Months Ended	
	July 31,		July 31,	
	2014	2013	2014	2013
Americas	\$940,946	\$678,535	\$1,817,323	\$1,309,643
Europe	246,532	173,705	477,342	336,531
Asia Pacific	131,073	104,854	250,658	203,553
	\$1,318,551	\$957,094	\$2,545,323	\$1,849,727

Americas revenue attributed to the United States was approximately 94 percent and 96 percent for the three months ended July 31, 2014 and 2013, respectively, and approximately 94 percent and 95 percent for the six months ended July 31, 2014 and 2013, respectively. No other country represented more than ten percent of total revenue during the three and six months ended July 31, 2014 and 2013.

## Table of Contents

### Revenue Recognition

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

"Other revenue" consists primarily of training fees.

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

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

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

### Subscription and Support Revenues

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

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

### Professional Services and Other Revenues

The majority of the Company's professional services contracts are on a time and material basis. When these services are not combined with subscription revenues as a single unit of accounting, as discussed below, these revenues are recognized as the services are rendered for time and material contracts, and when the milestones are achieved and accepted by the customer for fixed price contracts. Training revenues are recognized as the services are performed.

### Multiple Deliverable Arrangements

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

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

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

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

Table of Contents

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

Deferred Revenue

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

Deferred revenue that will be recognized during the succeeding 12 month period is recorded as current deferred revenue and the remaining portion is recorded as noncurrent.

Deferred Commissions

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

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

Cash and Cash Equivalents

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

Marketable Securities

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

Fair Value Measurement

The Company measures its cash equivalents, marketable securities and foreign currency derivative contracts at fair value.

The additional disclosures regarding the Company's fair value measurements are included in Note 2 "Investments".

Table of Contents

Property and Equipment

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

Computer, equipment and software	3 to 9 years
Furniture and fixtures	5 years
Leasehold improvements	Shorter of the estimated lease term or 10 years
Building improvements	Amortized over the estimated useful lives of the respective assets when they are ready for their intended use.

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

Capitalized Internal-Use Software Costs

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

Goodwill, Intangible Assets, Long-Lived Assets and Impairment Assessments

The Company evaluates and tests the recoverability of its goodwill for impairment at least annually during the fourth quarter or more often if and when circumstances indicate that goodwill may not be recoverable.

Intangible assets are amortized over their useful lives. Each period the Company evaluates the estimated remaining useful life of its intangible assets and whether events or changes in circumstances warrant a revision to the remaining period of amortization. The carrying amounts of these assets are periodically reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of these assets may not be recoverable.

Recoverability of these assets is measured by comparison of the carrying amount of each asset to the future undiscounted cash flows the asset is expected to generate. If the undiscounted cash flows used in the test for recoverability are less than the carrying amount of these assets, then the carrying amount of such assets is reduced to fair value.

The Company evaluates the recoverability of its long-lived assets for possible impairment whenever events or circumstances indicate that the carrying amount of such assets may not be recoverable. If such review indicates that the carrying amount of long-lived assets is not recoverable, the carrying amount of such assets is reduced to fair value.

Business Combinations

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

Leases and Asset Retirement Obligations

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

the term of the agreement.

9

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Table of Contents

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

The Company records assets and liabilities for the estimated construction costs incurred under build-to-suit lease arrangements to the extent it is involved in the construction of structural improvements or takes construction risk prior to commencement of a lease.

**Accounting for Stock-Based Compensation**

The Company recognizes stock-based expenses related to stock options and restricted stock awards on a straight-line basis over the requisite service period of the awards, which is generally the vesting term of four years. The Company recognizes stock-based expenses related to shares issued pursuant to its 2004 Employee Stock Purchase Plan (“ESPP”) on a straight-line basis over the offering period, which is 12 months. Stock-based expenses are recognized net of estimated forfeiture activity. The estimated forfeiture rate applied is based on historical forfeiture rates. The Company does not anticipate paying any cash dividends in the foreseeable future and therefore uses an expected dividend yield of zero in the option pricing model.

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

	Three Months Ended		Six Months Ended		
	July 31,		July 31,		
Stock Options	2014	2013	2014	2013	
Volatility	37	% 39-43	% 37	% 39-43	%
Estimated life	3.5 years	3.1 years	3.5 years	3.1 years	
Risk-free interest rate	1.25-1.46	% 0.48-0.95	% 1.20-1.46	% 0.48-0.95	%
Weighted-average fair value per share of grants	\$15.81	\$10.89	\$16.15	\$11.10	

	Three Months Ended		Six Months Ended		
	July 31,		July 31,		
ESPP	2014	2013	2014	2013	
Volatility	34-35	% 31-32	% 34-35	% 31-32	%
Estimated life	0.75 years	0.75 years	0.75 years	0.75 years	
Risk-free interest rate	0.07-0.16	% 0.07-0.10	% 0.07-0.16	% 0.07-0.10	%
Weighted-average fair value per share of grants	\$14.53	\$9.69	\$14.53	\$9.69	

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

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

**Income Taxes**

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



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

## Table of Contents

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

### Foreign Currency Translation

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

### Warranties and Indemnification

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

The Company's arrangements generally include certain provisions for indemnifying customers against liabilities if its products or services infringe a third-party's intellectual property rights. To date, the Company has not incurred any material costs as a result of such obligations and has not accrued any liabilities related to such obligations in the accompanying condensed consolidated financial statements.

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

### New Accounting Pronouncement

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2014-09, "Revenue from Contracts with Customers (Topic 606)" ("ASU 2014-09") which amended the existing FASB Accounting Standards Codification. This standard establishes a principle for recognizing revenue upon the transfer of promised goods or services to customers, in an amount that reflects the expected consideration received in exchange for those goods or services. The standard also provides guidance on the recognition of costs related to obtaining and fulfilling customer contracts. ASU 2014-09 is effective for fiscal 2018, including interim periods within that reporting period. Early adoption is not permitted. The Company is currently in the process of assessing the adoption methodology, which allows the amendment to be applied retrospectively to each prior period presented, or with the cumulative effect recognized as of the date of initial application. The Company is also evaluating the impact of the adoption of ASU 2014-09 on its consolidated financial statements and has not determined whether the effect will be material.



Table of Contents

## 2. Investments

## Marketable Securities

At July 31, 2014, marketable securities consisted of the following (in thousands):

Investments classified as Marketable Securities	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Corporate notes and obligations	\$543,071	\$1,906	\$(428)	) \$544,549
U.S. treasury securities	33,592	15	(6)	) 33,601
Mortgage backed obligations	50,270	195	(219)	) 50,246
Asset backed securities	99,312	52	(133)	) 99,231
Municipal securities	36,506	4	(143)	) 36,367
Foreign government obligations	23,931	302	0	) 24,233
U.S. agency obligations	27,642	9	(12)	) 27,639
Covered bonds	79,975	1,192	0	) 81,167
Total marketable securities	\$894,299	\$3,675	\$(941)	) \$897,033

At January 31, 2014, marketable securities consisted of the following (in thousands):

Investments classified as Marketable Securities	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Corporate notes and obligations	\$340,706	\$1,314	\$(170)	) \$341,850
U.S. treasury securities	16,016	28	0	) 16,044
Mortgage backed obligations	24,888	281	(93)	) 25,076
Asset backed securities	38,213	39	(35)	) 38,217
Municipal securities	2,000	1	(3)	) 1,998
Foreign government obligations	24,305	171	(2)	) 24,474
U.S. agency obligations	14,726	9	(10)	) 14,725
Covered bonds	76,282	717	(1)	) 76,998
Total marketable securities	\$537,136	\$2,560	\$(314)	) \$539,382

The duration of the investments classified as marketable securities is as follows (in thousands):

	As of July 31, 2014	January 31, 2014
Recorded as follows:		
Short-term (due in one year or less)	\$69,850	\$57,139
Long-term (due after one year)	827,183	482,243
	\$897,033	\$539,382

Table of Contents

As of July 31, 2014, the following marketable securities were in an unrealized loss position (in thousands):

	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Corporate notes and obligations	\$156,412	\$(396)	\$3,273	\$(32)	\$159,685	\$(428)
U.S. treasury securities	7,085	(6)	0	0	7,085	(6)
Mortgage backed obligations	32,289	(184)	2,791	(35)	35,080	(219)
Asset backed securities	52,247	(123)	2,550	(10)	54,797	(133)
Municipal securities	34,471	(143)	0	0	34,471	(143)
U.S. agency obligations	11,488	(12)	0	0	11,488	(12)
	\$293,992	\$(864)	\$8,614	\$(77)	\$302,606	\$(941)

The unrealized loss for each of these fixed rate marketable securities ranged from less than \$1,000 to \$20,000. The Company does not believe any of the unrealized losses represent an other-than-temporary impairment based on its evaluation of available evidence as of July 31, 2014. The Company expects to receive the full principal and interest on all of these marketable securities.

**Fair Value Measurement**

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

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

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

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

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

Table of Contents

The following table presents information about the Company's assets and liabilities that are measured at fair value as of July 31, 2014 and indicates the fair value hierarchy of the valuation (in thousands):

Description	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balances as of July 31, 2014
Cash equivalents (1):				
Time deposits	\$ 0	\$104,270	\$0	\$104,270
Money market mutual funds	114,962	0	0	114,962
Marketable securities:				
Corporate notes and obligations	0	544,549	0	544,549
U.S. treasury securities	0	33,601	0	33,601
Mortgage backed obligations	0	50,246	0	50,246
Asset backed securities	0	99,231	0	99,231
Municipal securities	0	36,367	0	36,367
Foreign government obligations	0	24,233	0	24,233
U.S. agency obligations	0	27,639	0	27,639
Covered bonds	0	81,167	0	81,167
Foreign currency derivative contracts (2)	0	322	0	322
Total Assets	\$ 114,962	\$1,001,625	\$0	\$1,116,587
Liabilities				
Foreign currency derivative contracts (3)	\$ 0	\$2,432	\$0	\$2,432
Total Liabilities	\$ 0	\$2,432	\$0	\$2,432

(1)Included in "cash and cash equivalents" in the accompanying condensed consolidated balance sheet as of July 31, 2014, in addition to \$555.5 million of cash.

(2)Included in "prepaid expenses and other current assets" in the accompanying condensed consolidated balance sheet as of July 31, 2014.

(3)Included in "accounts payable, accrued expenses and other liabilities" in the condensed consolidated balance sheet as of July 31, 2014.

Table of Contents

The following table presents information about the Company's assets and liabilities that are measured at fair value as of January 31, 2014 and indicates the fair value hierarchy of the valuation (in thousands):

Description	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balances as of January 31, 2014
Cash equivalents (1):				
Time deposits	\$ 0	\$ 212,700	\$0	\$212,700
Money market mutual funds	87,898	0	0	87,898
Marketable securities:				
Corporate notes and obligations	0	341,850	0	341,850
U.S. treasury securities	0	16,044	0	16,044
Mortgage backed obligations	0	25,076	0	25,076
Asset backed securities	0	38,217	0	38,217
Municipal securities	0	1,998	0	1,998
Foreign government obligations	0	24,474	0	24,474
U.S. agency obligations	0	14,725	0	14,725
Covered bonds	0	76,998	0	76,998
Foreign currency derivative contracts (2)	0	1,598	0	1,598
Total Assets	\$ 87,898	\$ 753,680	\$0	\$841,578
Liabilities				
Foreign currency derivative contracts (3)	\$ 0	\$ 1,801	\$0	\$1,801
Total Liabilities	\$ 0	\$ 1,801	\$0	\$1,801

(1)Included in "cash and cash equivalents" in the accompanying condensed consolidated balance sheet as of January 31, 2014, in addition to \$481.0 million of cash.

(2)Included in "prepaid expenses and other current assets" in the accompanying condensed consolidated balance sheet as of January 31, 2014.

(3)Included in "accounts payable, accrued expenses and other liabilities" in the accompanying condensed consolidated balance sheet as of January 31, 2014.

#### Derivative Financial Instruments

The Company enters into foreign currency derivative contracts with financial institutions to reduce the risk that its cash flows and earnings will be adversely affected by foreign currency exchange rate fluctuations. The Company uses forward currency derivative contracts to minimize the Company's exposure to balances primarily denominated in Euros, Japanese yen, Canadian dollars and British pounds. The Company's foreign currency derivative contracts which are not designated as hedging instruments are used to reduce the exchange rate risk associated primarily with intercompany receivables and payables. The Company's program is not designated for trading or speculative purposes. As of July 31, 2014 and January 31, 2014, the foreign currency derivative contracts that were not settled are recorded at fair value on the condensed consolidated balance sheets.

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

Table of Contents

Details on outstanding foreign currency derivative contracts related primarily to intercompany receivables and payables are presented below (in thousands):

	As of July 31, 2014	January 31, 2014
Notional amount of foreign currency derivative contracts	\$457,576	\$563,060
Fair value of foreign currency derivative contracts	\$(2,110	) \$(203

The fair value of the Company's outstanding derivative instruments are summarized below (in thousands):

	Balance Sheet Location	Fair Value of Derivative Instruments	
		As of July 31, 2014	January 31, 2014
<b>Derivative Assets</b>			
Derivatives not designated as hedging instruments:			
Foreign currency derivative contracts	Prepaid expenses and other current assets	\$322	\$1,598
<b>Derivative Liabilities</b>			
Derivatives not designated as hedging instruments:			
Foreign currency derivative contracts	Accounts payable, accrued expenses and other liabilities	\$2,432	\$1,801

The effect of the derivative instruments not designated as hedging instruments on the condensed consolidated statements of operations during the three and six months ended July 31, 2014 and 2013, respectively, are summarized below (in thousands):

Derivatives Not Designated as Hedging Instruments	Location	Gains (Losses) on Derivative Instruments Recognized in Income	
		Three Months Ended July 31, 2014	2013
Foreign currency derivative contracts	Other expense	\$(2,914	) \$(2,411
<b>Derivatives Not Designated as Hedging Instruments</b>			
Gains (Losses) on Derivative Instruments Recognized in Income			
Six Months Ended July 31,			
Location			
Foreign currency derivative contracts	Other expense	\$(2,006	) \$(116

**Strategic Investments**

The Company has three investments in marketable equity securities measured using quoted prices in their respective active markets and certain interests in non-marketable equity and debt securities that are collectively considered strategic investments. As of July 31, 2014, the fair value of the Company's marketable equity securities of \$10.7 million includes an unrealized gain of \$8.5 million. As of January 31, 2014, the Company had three investments in marketable equity securities which had a fair value of \$15.5 million, which included an unrealized gain of \$13.3



million. These investments are recorded in other assets, net on the condensed consolidated balance sheets. The Company's interest in non-marketable equity and debt securities consists of noncontrolling equity and debt investments in privately-held companies. The Company's investments in these privately-held companies are reported at cost or marked down to fair value when an event or circumstance indicates an other-than-temporary decline in value has occurred.

Table of Contents

These investments are valued using significant unobservable inputs or data in an inactive market and the valuation requires the Company's judgment due to the absence of market prices and inherent lack of liquidity.

As of July 31, 2014 and January 31, 2014, the carrying value of the Company's investments in privately-held companies was \$109.6 million and \$77.0 million, respectively. These investments are recorded in other assets, net on the condensed consolidated balance sheets. The estimated fair value of the Company's investments in privately-held companies was \$215.0 million as of July 31, 2014.

**Investment Income**

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

	Three Months Ended		Six Months Ended	
	July 31,		July 31,	
	2014	2013	2014	2013
Interest income	\$2,567	\$3,374	\$4,331	\$6,771
Realized gains	229	4,762	346	5,400
Realized losses	(141	) (3,749	) (244	) (4,430
Total investment income	\$2,655	\$4,387	\$4,433	\$7,741

Reclassification adjustments out of accumulated other comprehensive loss into net income (loss) were immaterial for the three and six months ended July 31, 2014 and 2013.

**3. Property and Equipment**

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

	As of	As of
	July 31,	January 31,
	2014	2014
Property and equipment, net		
Land and building improvements	\$137,653	\$297,835
Computers, equipment and software	1,066,947	931,171
Furniture and fixtures	67,733	58,956
Leasehold improvements	341,372	296,390
Building in progress—leased facility	73,219	40,171
	1,686,924	1,624,523
Less accumulated depreciation and amortization	(496,994	) (383,777
	\$1,189,930	\$1,240,746

Land and building improvements held for sale \$160,181 \$0

Depreciation and amortization expense totaled \$60.7 million and \$41.7 million for the three months ended July 31, 2014 and 2013, respectively, and totaled \$117.1 million and \$72.5 million for the six months ended July 31, 2014 and 2013, respectively.

Computers, equipment and software at July 31, 2014 and January 31, 2014 included a total of \$693.4 million and \$612.0 million acquired under capital lease agreements, respectively. Accumulated amortization relating to computers, equipment and software under capital leases totaled \$154.6 million and \$109.1 million, respectively, at July 31, 2014 and January 31, 2014. Amortization of assets under capital leases is included in depreciation and amortization expense.

Table of Contents

In November 2010, the Company purchased approximately 14 net acres of undeveloped real estate in San Francisco, California, including entitlements and improvements associated with the land. In addition to the amounts reflected in the table above, the Company recorded \$23.3 million in purchased intangible assets related to perpetual parking rights associated with an existing parking garage situated on the land. The perpetual parking rights are classified as a purchased intangible asset as they represent an intangible right to use the existing garage. The Company has capitalized pre-construction activities related to the development of the land, including interest costs and property taxes since the November 2010 purchase. During the first quarter of fiscal 2013, the Company suspended pre-construction activity. The total carrying value of the land, building improvements and perpetual parking rights was \$321.1 million as of July 31, 2014. In April 2014, the Company entered into an agreement to sell 8.8 net acres of this undeveloped real estate, for which the Company received a nonrefundable deposit in the amount of \$30.0 million. As of July 31, 2014, the Company does not expect this sale to close within twelve months and therefore this portion of the Company's undeveloped real estate does not meet held for sale criteria. This sale is subject to certain closing conditions.

As of July 31, 2014, the remaining 5.2 net acres of the Company's undeveloped real estate met the criteria as held for sale, and as a result, the Company classified this portion of the Company's land and building improvements, which totaled \$160.2 million, as held for sale on the accompanying condensed consolidated balance sheet. Subsequent to July 31, 2014, the Company sold approximately 3.7 net acres of the undeveloped real estate that was classified as held for sale as of July 31, 2014, for a total of \$72.5 million. The Company will recognize a gain of \$7.8 million on the sale of this portion of the Company's land and building improvements in the three months ended October 31, 2014. Separately, subsequent to July 31, 2014, the Company entered into an agreement to sell the remaining 1.5 net acres of undeveloped real estate that was classified as held for sale as of July 31, 2014. The sale of this portion of the Company's undeveloped real estate is expected to close within twelve months and is subject to certain closing conditions. As of July 31, 2014, the fair value of this portion of the Company's land and building improvements exceeds the carrying value based on recent market activity.

In December 2012, the Company entered into a lease agreement for approximately 445,000 rentable square feet of office space in San Francisco, California. The space rented is for the total office space available in the building, which is in the process of being constructed. As a result of the Company's involvement during the construction period, the Company is considered for accounting purposes to be the owner of the construction project. As of July 31, 2014, the Company had capitalized \$73.2 million of construction costs, based on the construction costs incurred to date by the landlord, and recorded a corresponding noncurrent financing obligation liability of \$73.2 million. As of January 31, 2014, the Company had capitalized \$40.2 million of construction costs, based on the construction costs incurred to date by the landlord, and recorded a corresponding noncurrent financing obligation liability of \$40.2 million. The total expected financing obligation associated with this lease upon completion of the construction of the building, inclusive of the amounts currently recorded, is \$335.8 million (See Note 9 "Commitments" for future commitment details). The obligation will be settled through monthly lease payments to the landlord once the construction is complete and the office space is ready for occupancy.

There was no impairment of long-lived assets during the three and six months ended July 31, 2014 and 2013, respectively.

#### 4. Convertible Senior Notes and Term Loan

##### Convertible Senior Notes

(In thousands)	Par Value	Equity Component Recorded at Issuance	Liability Component July 31, 2014	Component of Par Value as of January 31, 2014
0.75% Convertible Senior Notes due January 15, 2015	\$271,280	\$125,530	(1) \$265,102	\$542,159
0.25% Convertible Senior Notes due April 1, 2018	1,150,000	122,421	(2) 1,058,737	1,046,930

(1) This amount represents the equity component recorded at the initial issuance of the 0.75% convertible senior notes. As of July 31, 2014, \$6.2 million was reclassified as temporary equity on the condensed consolidated balance sheet as these notes are convertible.

(2) This amount represents the equity component recorded at the initial issuance of the 0.25% convertible senior notes.

In January 2010, the Company issued at par value \$575.0 million of 0.75% convertible senior notes (the "0.75% Senior Notes") due January 15, 2015, unless earlier purchased by the Company or converted. Interest is payable semi-annually in arrears on January 15 and July 15 of each year. In March 2013, the Company issued at par value \$1.15 billion of 0.25% convertible senior notes (the "0.25% Senior Notes", and together with the 0.75% Senior Notes, the "Notes") due April 1, 2018, unless earlier purchased by the Company or converted. Interest is payable semi-annually, in arrears on April 1 and October 1 of each year.

Table of Contents

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

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

	Conversion Rate per \$1,000 Par Value	Initial Conversion Price per Share	Convertible Date
0.75% Senior Notes	46.8588	\$21.34	October 15, 2014
0.25% Senior Notes	15.0512	\$66.44	January 1, 2018

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

during any fiscal quarter, if, for at least 20 trading days during the 30 consecutive trading day period ending on the last trading day of the immediately preceding fiscal quarter, the last reported sales price of the Company's common stock for such trading day is greater than or equal to 130% of the applicable conversion price on such trading day share of common stock on such last trading day;

in certain situations, when the trading price of the Notes is less than 98% of the product of the sale price of the Company's common stock and the conversion rate;

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

at any time on or after the convertible dates noted above.

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

In accounting for the issuances of the Notes, the Company separated the Notes into liability and equity components. The carrying amount of the liability component was calculated by measuring the fair value of a similar liability that does not have an associated convertible feature. The carrying amount of the equity component representing the conversion option was determined by deducting the fair value of the liability component from the par value of the Notes as a whole. The excess of the principal amount of the liability component over its carrying amount ("debt discount") is amortized to interest expense over the term of the Notes. The equity component is not remeasured as long as it continues to meet the conditions for equity classification.

In accounting for the transaction costs related to the Notes issuances, the Company allocated the total amount incurred to the liability and equity components based on their relative values. Transaction costs attributable to the liability component are being amortized to expense over the terms of the Notes, and transaction costs attributable to the equity component were netted with the equity component in temporary stockholders' equity and stockholders' equity. Additionally, the Company recorded a deferred tax liability of \$51.1 million in connection with the 0.75% Senior Notes.



Table of Contents

The Notes consisted of the following (in thousands):

	As of July 31, 2014	January 31, 2014
Liability component :		
Principal:		
0.75% Senior Notes (1)	\$271,280	\$568,864
0.25% Senior Notes (1)	1,150,000	1,150,000
Less: debt discount, net		
0.75% Senior Notes (2)	(6,178	) (26,705
0.25% Senior Notes (3)	(91,263	) (103,070
Net carrying amount	\$1,323,839	\$1,589,089

(1)The effective interest rates of the 0.75% Senior Notes and 0.25% Senior Notes are 5.86% and 2.53%, respectively. These interest rates were based on the interest rates of a similar liability at the time of issuance that did not have an associated convertible feature.

(2)Included in the condensed consolidated balance sheets within Convertible 0.75% Senior Notes (which is classified as a current liability, as these notes were convertible) and is amortized over the life of the 0.75% Senior Notes using the effective interest rate method.

(3)Included in the condensed consolidated balance sheets within Convertible 0.25% Senior Notes (which is classified as a noncurrent liability) and is amortized over the life of the 0.25% Senior Notes using the effective interest rate method.

The total estimated fair values of the Company's 0.75% Senior Notes and 0.25% Senior Notes at July 31, 2014 were \$699.9 million and \$1.3 billion, respectively. The fair value was determined based on the closing trading price per \$100 of the 0.75% Senior Notes and 0.25% Senior Notes as of the last day of trading for the second quarter of fiscal 2015.

Based on the closing price of the Company's common stock of \$54.25 on July 31, 2014, the if-converted value of the 0.75% Senior Notes exceeded their principal amount by approximately \$418.3 million and the if-converted value of the 0.25% Senior Notes was less than their principal amount.

During the six months ended July 31, 2014, a portion of the 0.75% Senior Notes outstanding was converted by noteholders. The Company repaid \$297.6 million of principal balance of the 0.75% Senior Notes. The Company also distributed approximately 9.1 million shares of the Company's common stock to noteholders which represents the conversion value in excess of the principal amount. The Company received approximately 9.1 million shares of the Company's common stock from the convertible note hedges related to the 0.75% Senior Notes. The Company recorded a loss of \$8.9 million during the six months ended July 31, 2014 related to the extinguishment of the 0.75% Senior Notes converted by noteholders. This amount represents the difference between the fair market value allocated to the liability component on settlement date and the net carrying amount of the liability component and unamortized debt issuance costs on settlement date.

As of July 31, 2014, the remaining principal balance of the 0.75% Senior Notes outstanding was approximately \$271.3 million. The remaining principal balance of the 0.75% Senior Notes matures on January 15, 2015 unless earlier purchased by the Company or converted by noteholders. As of the date of the filing of this Form 10-Q, the Company has received conversion notices for an additional \$89.6 million of the principal balance of the 0.75% Senior Notes.

**Note Hedges**

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

(in thousands, except for shares)

Date                      Purchase                      Shares

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0.75% Note Hedges	January 2010	\$ 126,500	26,943,812
0.25% Note Hedges	March 2013	\$ 153,800	17,308,880

20

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Table of Contents

The Note Hedges cover shares of the Company's common stock at a strike price that corresponds to the initial conversion price of the respective Notes, also subject to adjustment, and are exercisable upon conversion of the Notes. The Note Hedges will expire upon the maturity of the Notes. The Note Hedges are intended to reduce the potential economic dilution upon conversion of the Notes in the event that the market value per share of the Company's common stock, as measured under the Notes, at the time of exercise is greater than the conversion price of the Notes. The Note Hedges are separate transactions and are not part of the terms of the Notes. Holders of the Notes will not have any rights with respect to the Note Hedges. The Company initially recorded a deferred tax asset of \$51.4 million in connection with the 0.75% Note Hedges. The Note Hedges do not impact earnings per share. As a result of the conversions of the 0.75% Senior Notes, the Company exercised its rights on the 0.75% Note Hedges and received approximately 9.1 million shares of the Company's common stock during the six months ended July 31, 2014.

## Warrants

	Date	Proceeds (in thousands)	Shares	Strike Price
0.75% Warrants	January 2010	\$59,300	26,943,812	\$29.88
0.25% Warrants	March 2013	\$84,800	17,308,880	\$90.40

Separately, in January 2010 and March 2013, the Company also entered into warrant transactions (the "0.75% Warrants" and the "0.25% Warrants", respectively) (collectively, the "Warrants"), whereby the Company sold warrants to acquire, subject to anti-dilution adjustments, shares of the Company's common stock. As the average market value per share of the Company's common stock for the reporting period, as measured under the 0.75% Warrants, exceeds the strike price of the 0.75% Warrants, the 0.75% Warrants would have a dilutive effect on the Company's earnings/loss per share if the Company were to report net income for the three month and six month periods ended July 31, 2014. The Warrants were anti-dilutive for the periods presented. The Warrants are separate transactions, entered into by the Company and are not part of the terms of the Notes or Note Hedges. Holders of the Notes and Note Hedges will not have any rights with respect to the Warrants.

## Term Loan

On July 11, 2013, the Company entered into a credit agreement (the "Credit Agreement") with Bank of America, N.A. and certain other lenders. The Credit Agreement provides for a \$300.0 million term loan (the "Term Loan") maturing on July 11, 2016 (the "Maturity Date") and bears interest at the Company's option at either a base rate plus a spread of 0.50% to 1.00% or an adjusted LIBOR rate as defined in the Credit Agreement plus a spread of 1.50% to 2.00%. The Company entered into the Term Loan in conjunction with and for purposes of funding the acquisition of ExactTarget in fiscal 2014.

Interest on the Term Loan is due and payable in arrears quarterly for the loan bearing interest at the base rate and at the end of an interest period in the case of the loan bearing interest at the adjusted LIBOR rate. The Term Loan is payable in quarterly installments equal to \$7.5 million beginning on September 30, 2013, with the remaining outstanding principal amount of the Term Loan being due and payable on the Maturity Date. The Company may prepay the Term Loan, in whole or in part at any time during the term of the Term Loan. Amounts repaid or prepaid may not be reborrowed under the terms of the Credit Agreement. The Term Loan is secured by a pledge of 100 percent of the equity securities of the Company's direct domestic subsidiaries and 65 percent of the equity securities of the Company's foreign subsidiaries.

The Credit Agreement contains certain customary affirmative and negative covenants, including a consolidated leverage ratio covenant, a consolidated interest coverage ratio covenant, a limit on the Company's ability to incur additional indebtedness, issue preferred stock or pay dividends, and certain other restrictions on the Company's activities each defined specifically in the Credit Agreement. The Company was in compliance with the Credit Agreement's covenants as of July 31, 2014.

The weighted average interest rate on the Term Loan was 1.8% for the three months ended July 31, 2014. As of July 31, 2014, the current portion outstanding under the Term Loan was \$30.0 million and the noncurrent outstanding portion was \$240.0 million. Future principal payments on the Term Loan are payable as follows: \$15.0 million during the remaining six months of fiscal 2015; \$30.0 million during fiscal 2016; and \$225.0 million during fiscal 2017.



Table of Contents

## Interest Expense on Convertible Senior Notes and Term Loan

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

	Three Months Ended July 31,		Six Months Ended July 31,	
	2014	2013	2014	2013
Contractual interest expense	\$2,684	\$2,178	\$5,587	\$3,593
Amortization of debt issuance costs	1,130	1,179	2,358	1,920
Amortization of debt discount	9,216	12,352	20,200	21,592
	\$13,030	\$15,709	\$28,145	\$27,105

## 5. Other Balance Sheet Accounts

## Prepaid Expenses and Other Current Assets

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

	As of July 31, 2014	January 31, 2014
Deferred income taxes, net	\$51,395	\$49,279
Prepaid income taxes	21,511	23,571
Customer contract asset	39,540	77,368
Prepaid expenses and other current assets	183,915	158,962
	\$296,361	\$309,180

Customer contract asset reflects future billings of amounts that are contractually committed by ExactTarget's existing customers as of the acquisition date that will be billed in the next 12 months. As the Company bills these customers this balance will reduce and accounts receivable will increase.

## Capitalized Software, net

Capitalized software consisted of the following (in thousands):

	As of July 31, 2014	January 31, 2014
Capitalized internal-use software development costs, net of accumulated amortization of \$118,331 and \$101,687, respectively	\$82,399	\$72,915
Acquired developed technology, net of accumulated amortization of \$348,029 and \$294,628, respectively	367,100	409,002
	\$449,499	\$481,917

Capitalized internal-use software amortization expense totaled \$8.3 million and \$7.1 million for the three months ended July 31, 2014 and 2013, respectively, and totaled \$16.6 million and \$13.8 million for the six months ended July 31, 2014 and 2013, respectively. Acquired developed technology amortization expense totaled \$23.1 million and \$24.1 million for the three months ended July 31, 2014 and 2013, respectively, and totaled \$53.4 million and \$46.1 million for the six months ended July 31, 2014 and 2013, respectively.

The Company capitalized \$1.1 million and \$0.9 million of stock-based expenses related to capitalized internal-use software development and deferred professional services during the three months ended July 31, 2014 and 2013, respectively. The Company capitalized \$2.1 million and \$1.8 million of stock-based expenses related to capitalized internal-use software development and deferred professional services during the six months ended July 31, 2014 and 2013, respectively.



Table of Contents

## Goodwill

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

Goodwill totaled approximately \$3.5 billion at July 31, 2014 and January 31, 2014. During the three months ended July 31, 2014, the Company closed the measurement periods in relation to the acquisitions of ExactTarget, Inc. and EdgeSpring, Inc.

## Other Assets, net

Other assets consisted of the following (in thousands):

	As of July 31, 2014	January 31, 2014
Deferred income taxes, noncurrent, net	\$8,815	\$9,691
Long-term deposits	20,270	17,970
Purchased intangible assets, net of accumulated amortization of \$96,398 and \$66,399, respectively	386,121	416,119
Acquired intellectual property, net of accumulated amortization of \$13,653 and \$11,304, respectively	10,792	11,957
Strategic investments	120,289	92,489
Customer contract asset	6,384	18,182
Other	51,885	47,082
	\$604,556	\$613,490

Customer contract asset reflects the noncurrent portion of future billings that are contractually committed by ExactTarget's existing customers as of the acquisition date.

Purchased intangible assets amortization expense for the three months ended July 31, 2014 and 2013 was \$14.8 million and \$4.5 million, respectively, and for the six months ended July 31, 2014 and 2013 was \$30.0 million and \$7.0 million, respectively. Acquired intellectual property amortization expense for the three months ended July 31, 2014 and 2013 was \$1.2 million and \$1.1 million, respectively, and for the six months ended July 31, 2014 and 2013 was \$2.3 million and \$2.1 million, respectively.

## Accounts Payable, Accrued Expenses and Other Liabilities

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

	As of July 31, 2014	January 31, 2014
Accounts payable	\$83,604	\$64,988
Accrued compensation	308,901	397,002
Accrued other liabilities	324,011	235,543
Accrued income and other taxes payable	109,936	153,026
Accrued professional costs	22,111	15,864
Customer liability, current	27,820	53,957
Accrued rent	14,679	13,944
	\$891,062	\$934,324

Customer liability reflects the legal obligation to provide future services that are contractually committed by ExactTarget's existing customers but unbilled as of the acquisition date. As these services are invoiced, this balance will reduce and deferred revenue will increase.



Table of Contents

## Other Noncurrent Liabilities

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

	As of July 31, 2014	January 31, 2014
Deferred income taxes and income taxes payable	\$107,510	\$108,760
Customer liability, noncurrent	4,403	13,953
Financing obligation, building in progress-leased facility	73,219	40,171
Long-term lease liabilities and other	680,145	594,303
	\$865,277	\$757,187

Customer liability, noncurrent reflects the noncurrent fair value of the legal obligation to provide future services that are contractually committed by ExactTarget's existing customers but unbilled as of the acquisition date.

## 6. Stockholders' Equity

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

On July 10, 2014, the Company adopted the 2014 Inducement Plan with a reserve of 335,000 shares of common stock for future issuance solely for the granting of inducement stock options and equity awards to new employees, including employees of acquired companies. In addition, approximately 319,000 shares of common stock that remained available for grant under the 2006 Inducement Equity Incentive Plan (the "Prior Inducement Plan") as of July 9, 2014 were added to the 2014 Inducement Plan share reserve and the Prior Inducement Plan was terminated. Further, any shares of common stock subject to outstanding awards under the Prior Inducement Plan that expire, are forfeited, or are repurchased by the Company will also become available for future grant under the 2014 Inducement Plan. Termination of the Prior Inducement Plan did not affect the outstanding awards previously issued thereunder. The 2014 Inducement Plan was adopted without stockholder approval in reliance on the "employment inducement exemption" provided under the New York Stock Exchange Listed Company Manual.

As of July 31, 2014, \$26.0 million has been withheld on behalf of employees for future purchases under the ESPP and is recorded in accounts payable, accrued expenses and other liabilities.

Prior to February 1, 2006, options issued under the Company's stock option plans generally had a term of 10 years. From February 1, 2006 through July 3, 2013, options issued had a term of 5 years. After July 3, 2013, options issued have a term of 7 years.

Table of Contents

Stock activity excluding the ESPP is as follows:

	Shares Available for Grant	Options Outstanding		Aggregate Intrinsic Value (in thousands)
		Outstanding Stock Options	Weighted-Average Exercise Price	
Balance as of January 31, 2014	55,852,536	28,604,045	\$ 34.26	
Increase in shares authorized:				
2013 Equity Incentive Plan	2,268,869	0	0.00	
2014 Inducement Equity Incentive Plan	654,957	0	0.00	
Options granted under all plans	(1,807,655 )	1,807,655	55.57	
Restricted stock activity	(4,638,196 )	0	0.00	
Stock grants to board and advisory board members	(121,613 )	0	0.00	
Exercised	0	(3,221,389 )	22.17	
Plan shares expired	(1,781,907 )	0	0.00	
Cancelled	615,850	(615,850 )	31.07	
Balance as of July 31, 2014	51,042,841	26,574,461	37.25	\$454,843
Vested or expected to vest		24,955,109	\$ 36.69	\$440,812
Exercisable as of July 31, 2014		11,080,991	\$ 29.08	\$278,901

The total intrinsic value of the options exercised during the six months ended July 31, 2014 and 2013 was \$115.4 million and \$93.5 million, respectively. The intrinsic value is the difference between the current market value of the stock and the exercise price of the stock option.

The weighted-average remaining contractual life of vested and expected to vest options is approximately 3.7 years. As of July 31, 2014, options to purchase 11,080,991 shares were vested at a weighted average exercise price of \$29.08 per share and had a remaining weighted-average contractual life of approximately 2.1 years. The total intrinsic value of these vested options as of July 31, 2014 was \$278.9 million.

The following table summarizes information about stock options outstanding as of July 31, 2014:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted-Average Remaining Contractual Life (Years)	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price
\$0.58 to \$27.06	6,910,164	2.8	\$ 20.32	4,576,546	\$ 18.88
\$27.56 to \$34.63	1,293,888	3.5	31.18	551,607	31.19
\$35.63	3,975,708	1.3	35.63	3,475,239	35.63
\$35.87 to \$39.09	5,948,137	3.2	38.08	2,358,186	38.07
\$40.19 to \$52.14	824,423	5.4	43.02	119,413	42.39
\$52.30	5,467,129	6.3	52.30	0	0.00
\$53.60 to \$63.66	2,155,012	6.8	55.55	0	0.00
	26,574,461	3.8	\$ 37.25	11,080,991	\$ 29.08



Table of Contents

Restricted stock activity is as follows:

	Restricted Stock Outstanding		Aggregate Intrinsic Value (in thousands)
	Outstanding	Weighted- Average Exercise Price	
Balance as of January 31, 2014	24,653,578	\$0.001	
Granted	3,042,693	0.001	
Cancelled	(1,416,781)	) 0.001	
Vested and converted to shares	(4,044,508)	) 0.001	
Balance as of July 31, 2014	22,234,982	\$0.001	\$ 1,206,248
Expected to vest	19,296,284		\$ 1,046,823

The restricted stock, which upon vesting entitles the holder to one share of common stock for each share of restricted stock, has an exercise price of \$0.001 per share, which is equal to the par value of the Company's common stock, and generally vests over 4 years.

The weighted-average grant date fair value of the restricted stock issued for the six months ended July 31, 2014 and 2013 was \$58.65 and \$43.43, respectively.

**Common Stock**

The following number of shares of common stock were reserved and available for future issuance at July 31, 2014:

Options outstanding	26,574,461
Restricted stock awards and units outstanding	22,234,982
Stock available for future grant:	
2013 Equity Incentive Plan	50,387,884
2014 Inducement Equity Incentive Plan	654,957
2004 Employee Stock Purchase Plan	4,298,999
Convertible senior notes	30,020,642
Warrants	44,252,692
	178,424,617

**7. Income Taxes****Effective Tax Rate**

The Company computes its year-to-date provision for income taxes by applying the estimated annual effective tax rate to year to date pretax loss and adjusts the provision for discrete tax items recorded in the period. For the six months ended July 31, 2014, the Company reported a tax provision of \$20.3 million on a pretax loss of \$137.7 million, which resulted in a negative effective tax rate of 15 percent. The tax provision recorded was primarily related to income taxes in profitable jurisdictions outside of the U.S.

For the six months ended July 31, 2013, the Company reported a tax benefit of \$119.6 million on a pretax loss of \$110.7 million, which resulted in an effective tax rate of 108 percent. Primarily in connection with the acquisition of ExactTarget, the Company recorded a discrete tax benefit of \$128.8 million from a partial release of the Company's tax valuation allowance. The net deferred tax liability from the acquisition of ExactTarget provided an additional source of income to support the realizability of the Company's pre-existing deferred tax assets and as a result, the Company released a portion of its valuation allowance.

**Tax Benefits Related to Stock-Based Compensation**

The total income tax benefit related to stock-based awards was \$85.3 million and \$65.9 million for six months ended July 31, 2014 and 2013, respectively, the majority of which was not recognized as a result of the valuation allowance.

Table of Contents

## Unrecognized Tax Benefits and Other Considerations

The Company records liabilities related to its uncertain tax positions. Tax positions for the Company and its subsidiaries are subject to income tax audits by multiple tax jurisdictions throughout the world. Certain prior year tax returns are currently being examined by various taxing authorities in countries including the United States, Canada, Japan, Germany and the United Kingdom. To date, the Company has not received any material proposed adjustments. The Company believes that it has provided adequate reserves for its income tax uncertainties in all open tax years. In the next 12 months, the Company does not expect the unrecognized tax benefits balance to materially change.

## 8. Earnings/Loss Per Share

Basic earnings/loss per share is computed by dividing net income (loss) by the weighted-average number of common shares outstanding for the fiscal period. Diluted earnings/loss per share is computed by giving effect to all potential weighted average dilutive common stock, including options, restricted stock units, warrants and the convertible senior notes. The dilutive effect of outstanding awards and convertible securities is reflected in diluted earnings per share by application of the treasury stock method. Diluted loss per share for the three and six months ended July 31, 2014 are the same as basic loss per share as there is a net loss in these periods and inclusion of potentially issuable shares is anti-dilutive.

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

	Three Months Ended July 31,		Six Months Ended July 31,	
	2014	2013	2014	2013
Numerator:				
Net income (loss)	\$(61,088	) \$76,603	\$(157,999	) \$8,882
Denominator:				
Weighted-average shares outstanding for basic income (loss) per share	617,016	593,955	614,797	591,210
Effect of dilutive securities:				
Convertible senior notes	0	12,977	0	13,270
Employee stock awards	0	7,394	0	7,804
Warrants	0	10,330	0	11,581
Adjusted weighted-average shares outstanding and assumed conversions for diluted income (loss) per share	617,016	624,656	614,797	623,865

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

	Three Months Ended July 31,		Six Months Ended July 31,	
	2014	2013	2014	2013
Stock awards	18,868	9,310	20,116	8,172
Convertible senior notes	30,021	17,309	30,341	17,309
Warrants	44,253	17,309	44,253	17,309

## 9. Commitments

## Letters of Credit

As of July 31, 2014, the Company had a total of \$64.1 million in letters of credit outstanding substantially in favor of certain landlords for office space. These letters of credit renew annually and expire at various dates through December 2030.



Table of Contents

## Leases

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

As of July 31, 2014, the future minimum lease payments under non-cancelable operating and capital leases are as follows (in thousands):

	Capital Leases	Operating Leases	Financing Obligation, Building in Progress-Leased Facility(1)
Fiscal Period:			
Remaining six months of fiscal 2015	\$ 19,206	\$ 116,503	\$ 0
Fiscal 2016	88,493	232,255	1,777
Fiscal 2017	99,806	207,389	16,877
Fiscal 2018	107,878	168,019	21,107
Fiscal 2019	112,506	172,056	21,551
Thereafter	201,233	1,218,423	274,512
Total minimum lease payments	629,122	\$ 2,114,645	\$ 335,824
Less: amount representing interest	(84,493 )		
Present value of capital lease obligations	\$ 544,629		

(1) Total Financing Obligation, Building in Progress-Leased Facility noted above represents the total obligation on the lease agreement noted in Note 3 "Property and Equipment" and includes \$73.2 million that was recorded to Financing obligation, building in progress-leased facility, which is included in Other noncurrent liabilities on the balance sheet. The Company's agreements for the facilities and certain services provide the Company with the option to renew. The Company's future contractual obligations would change if the Company exercised these options.

On April 10, 2014, the Company entered into an office lease agreement to lease approximately 714,000 rentable square feet of an office building to be located in San Francisco, California. The lease payments associated with the lease will be approximately \$560.0 million over the 15.5 year term of the lease, beginning in the Company's first quarter of fiscal year 2018, which is reflected above under Operating Leases.

## 10. Legal Proceedings and Claims

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

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

The Company makes a provision for a liability relating to legal matters when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, estimated settlements, legal rulings, advice of legal counsel and other information and events pertaining to a particular matter. In management's opinion, resolution of all current matters is not expected to have a material adverse impact on the Company's condensed consolidated results of operations, cash flows or financial position. However, depending on the nature and timing of any such dispute, an unfavorable resolution of a matter could materially affect the Company's future results of operations or cash flows, or both, of a particular quarter.



Table of Contents

11. Related-Party Transactions

In January 1999, The Salesforce.com Foundation, a non-profit public charity, also referred to as the Foundation, was chartered to build philanthropic programs that are focused on youth and technology. The Company's chairman is the chairman of the Foundation. The Company's chairman, two of the Company's employees and one of the Company's board members hold four of the Foundation's ten board seats. The Company does not control the Foundation's activities, and accordingly, the Company does not consolidate the Foundation's statement of activities with its financial results.

Since the Foundation's inception, the Company has provided at no charge certain resources to Foundation employees such as office space. The value of these items was approximately \$690,000 for the six months ended July 31, 2014. Additionally, the Company has donated subscriptions to the Company's service to other qualified non-profit organizations. The Company also allows an affiliate of the Foundation to resell the Company's service to non-profit organizations and certain higher education entities. The Company does not charge the affiliate for these subscriptions, so any revenue from subscriptions provided to non-profit organizations is retained by the Foundation to fund its charitable work. The value of the subscriptions was approximately \$14.0 million for the six months ended July 31, 2014. The Company plans to continue these programs.

12. Additional Subsequent Events

RelateIQ, Inc.

On August 1, 2014, the Company acquired the outstanding stock of RelateIQ, Inc. ("RelateIQ"), a relationship intelligence platform company that uses data science and machine learning to automatically capture data from email, calendars and smartphone calls and provide data-science-driven insights in real time. The Company acquired RelateIQ for the assembled workforce and expected synergies with the Company's current offerings. Beginning with the fiscal quarter ended October 31, 2014, the Company will include the financial results of RelateIQ in its condensed consolidated financial statements from the date of acquisition. The total estimated purchase price for RelateIQ of \$340.2 million included \$1.1 million in cash, 6.3 million shares of salesforce.com common stock and \$1.1 million which represents the estimated fair market value of the employee stock awards assumed.

Table of Contents

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

The following discussion in "Management's Discussion and Analysis of Financial Condition and Results of Operations" ("MD&A") contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Forward-looking statements consist of, among other things, trend analyses, statements regarding future events, future financial performance, our anticipated growth, the effect of general economic and market conditions, our business strategy and our plan to build our business, including our strategy to be the leading provider of enterprise cloud computing applications and platforms and to lead the industry shift to the "customer company," our service performance and security, the expenses associated with new data centers, additional data center capacity, real estate and office facilities space, our operating results, new features and services, our strategy of acquiring or making investments in complementary businesses, joint ventures, services and technologies, and intellectual property rights, our ability to successfully integrate acquired businesses and technologies, our ability to continue the growth and to maintain deferred revenue and unbilled deferred revenue, our ability to protect our intellectual property rights, our ability to develop our brands, our ability to realize the benefits from strategic partnerships, the effect of evolving government regulations, the effect of foreign currency exchange rate and interest rate fluctuations on our financial results, the valuation of deferred tax assets, the potential availability of additional tax assets in the future and related matters, the impact of expensing stock options, the sufficiency of our capital resources, factors related to our outstanding convertible notes, term loan, compliance with our related debt covenants, and capital lease obligations, and current and potential litigation involving us, all of which are based on current expectations, estimates, and forecasts, and the beliefs and assumptions of our management. Words such as "expects," "anticipates," "aims," "projects," "intends," "plans," "believes," "estimates," "seeks," "assumes," "may," "should," "could," "foresees," variations of such words and expressions are also intended to identify such forward-looking statements. These forward-looking statements are subject to risks, uncertainties and assumptions that are difficult to predict. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. Readers are directed to risks and uncertainties identified below, under "Risk Factors" and elsewhere in this report, for factors that may cause actual results to be different than those expressed in these forward-looking statements. Except as required by law, we undertake no obligation to revise or update publicly any forward-looking statements for any reason.

## Overview

We are a leading provider of enterprise cloud computing solutions. We were founded on the concept of delivering customer relationship management, or CRM, applications via the Internet, or "cloud." We introduced our first CRM solution in February 2000 and we have expanded our offerings with new editions, solutions and enhanced features, through internal development and acquisitions. We sell to businesses of all sizes and in almost every industry worldwide on a subscription basis.

Our mission is to help our customers transform themselves into "customer companies" by empowering them to connect with their customers, partners, employees and products in entirely new ways. Our objective is to deliver solutions to help companies transform the way they sell, service, market and innovate. With our four core services—Sales Cloud, Service Cloud, ExactTarget Marketing Cloud and the Salesforce1 Platform—customers have the tools they need to build a next generation social front office with our social and mobile cloud technologies. Key elements of our strategy include:

- strengthening our market-leading solutions;
- extending distribution into high-growth markets;
- expanding relationships with our existing customer base;
- pursuing new customers;
- reducing our attrition rates;
- building our business in top markets globally, which includes building partnerships that help add customers; and
- encouraging the development of third-party applications on our cloud computing platforms.





## Table of Contents

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

To address these factors, we will need to, among other things, continue to add substantial numbers of paying subscriptions, upgrade our customers to fully featured versions or arrangements such as a Social Enterprise License Agreement, provide high quality technical support to our customers, encourage the development of third-party applications on our platforms and continue to focus on retaining customers at the time of renewal. Our plans to invest for future growth include the continuation of the expansion of our data center capacity, for example data center expansion in the United Kingdom, France and Germany, the hiring of additional personnel, particularly in direct sales, other customer-related areas and research and development, the expansion of domestic and international selling and marketing activities, specifically in Europe, continuing to develop our brands, the addition of distribution channels, the upgrade of our service offerings, the development of new services, the integration of acquired technologies, the expansion of our ExactTarget Marketing Cloud and Salesforce1 Platform service offerings and the additions to our global infrastructure to support our growth.

We also regularly evaluate acquisitions or investment opportunities in complementary businesses, joint ventures, services and technologies and intellectual property rights in an effort to expand our service offerings. We expect to continue to make such investments and acquisitions in the future and we plan to reinvest a significant portion of our incremental revenue in future periods to grow our business and continue our leadership role in the cloud computing industry. As a result of our aggressive growth plans, specifically our hiring plan and acquisition activities, we have incurred significant expenses from equity awards and amortization of purchased intangibles which have resulted in net losses on a GAAP basis. As we continue with our growth plan, we may continue to have net losses on a GAAP basis. Our typical subscription contract term is 12 to 36 months, although terms range from one to 60 months, so during any fiscal reporting period only a subset of active subscription contracts is eligible for renewal. We calculate our attrition rate as of the end of each month. Our current attrition rate calculation does not include the ExactTarget, Inc.

("ExactTarget") offerings. Our attrition rate was between nine and ten percent during the quarter ended July 31, 2014, which is consistent with the attrition rate as of January 31, 2014. We expect our attrition rate to remain in this range as we continue to expand our enterprise business and invest in customer success and related programs.

We expect marketing and sales costs, which were 51 percent of our total revenues for the three months ended July 31, 2014 and 50 percent for the same period a year ago, to continue to represent a substantial portion of total revenues in the future as we seek to grow our customer base, sell more products to existing customers, and build greater brand awareness.

### Fiscal Year

Our fiscal year ends on January 31. References to fiscal 2015, for example, refer to the fiscal year ending January 31, 2015.

### Operating Segments

We operate as one operating segment. Operating segments are defined as components of an enterprise for which separate financial information is evaluated regularly by the chief operating decision maker, who in our case is the chief executive officer, in deciding how to allocate resources and assess performance. Over the past few years, we have completed several acquisitions. These acquisitions have allowed us to expand our offerings, presence and reach in various market segments of the enterprise cloud computing market. While we have offerings in multiple enterprise cloud computing market segments, our business operates in one operating segment because our chief operating decision maker evaluates our financial information and resources and assesses the performance of these resources on a consolidated basis. Since we operate as one operating segment, all required financial segment information can be

found in the condensed consolidated financial statements.

31

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Table of Contents

## Sources of Revenues

We derive our revenues from two sources: (1) subscription revenues, which are comprised of subscription fees from customers accessing our enterprise cloud computing services and from customers paying for additional support beyond the standard support that is included in the basic subscription fees; and (2) related professional services such as process mapping, project management, implementation services and other revenue. “Other revenue” consists primarily of training fees. Subscription and support revenues accounted for approximately 94 percent of our total revenues for the six months ended July 31, 2014. Subscription revenues are driven primarily by the number of paying subscribers, varying service types, the price of our service and renewals. We define a “customer” as a separate and distinct buying entity (e.g., a company, a distinct business unit of a large corporation, a partnership, etc.) that has entered into a contract to access our enterprise cloud computing services. We define a “subscription” as a unique user account purchased by a customer for use by its employees or other customer-authorized users, and we refer to each such user as a “subscriber.” The number of paying subscriptions at each of our customers ranges from one to hundreds of thousands. None of our customers accounted for more than five percent of our revenues during the six months ended July 31, 2014 and 2013.

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

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

In determining whether professional services can be accounted for separately from subscription and support revenues, we consider a number of factors, which are described in “Critical Accounting Estimates—Revenue Recognition” below.

## Revenue by Cloud Service Offering

We are providing the information below on a supplemental basis to give additional insight into the revenue performance of our individual core service offerings.

Subscription and support revenues consisted of the following by core service offering (in millions):

	Three Months Ended July 31, 2014	Six Months Ended July 31, 2014
Sales Cloud	\$610.1	\$1,186.7
Service Cloud	318.7	613.5
Salesforce1 Platform and Other	181.4	346.3
ExactTarget Marketing Cloud	122.4	233.4
Total	\$1,232.6	\$2,379.9

In situations where a customer purchases multiple cloud offerings, such as through a Social Enterprise License Agreement, we allocate the contract value to each core service offering based on the customer’s estimated product demand plan and the service that was provided at the inception of the contract. We do not update these allocations based on actual product usage during the term of the contract. We have allocated approximately 10 percent of our total subscription and support revenues for the three and six months ended July 31, 2014, based on customers’ estimated product demand plans and these allocated amounts are included in the table above.



Table of Contents

Additionally, some of our core service offerings have similar features and functions. For example, customers may use the Sales Cloud, the Service Cloud or our Salesforce1 Platform to record account and contact information, which are similar features across these core service offerings. Depending on a customer's actual and projected business requirements, more than one core service offering may satisfy the customer's current and future needs. We record revenue based on the individual products ordered by a customer, and not according to the customer's business requirements and usage. In addition, as we introduce new features and functions within each offering, and refine our allocation methodology for changes in our business, we do not expect it to be practical to adjust historical revenue results by core service offering for comparability. Accordingly, comparisons of revenue performance by core service offering over time may not be meaningful.

We estimate that for the remainder of fiscal 2015, approximately 50 percent of total subscription and support revenue will continue to be derived from subscriptions to our Sales Cloud offering.

**Seasonal Nature of Deferred Revenue and Accounts Receivable**

Deferred revenue primarily consists of billings to customers for our subscription service. Over 90 percent of the value of our billings to customers is for our subscription and support service. We generally invoice our customers in annual cycles. Occasionally, we bill customers for their multi-year contract on a single invoice which results in an increase in noncurrent deferred revenue. We typically issue renewal invoices in advance of the renewal service period, and depending on timing, the initial invoice for the subscription and services contract and the subsequent renewal invoice may occur in different quarters. This may result in an increase in deferred revenue and accounts receivable. There is a disproportionate weighting towards annual billings in the fourth quarter, primarily as a result of large enterprise account buying patterns. Our fourth quarter has historically been our strongest quarter for new business and renewals. The year on year compounding effect of this seasonality in both billing patterns and overall new and renewal business causes the value of invoices that we generate in the fourth quarter for both new business and renewals to increase as a proportion of our total annual billings. Approximately 70 percent of all subscription and support invoices issued during the three months ended July 31, 2014 had annual terms.

Accordingly, the sequential quarterly changes in accounts receivable and the related deferred revenue during the first three quarters of our fiscal year are not necessarily indicative of the billing activity that occurs in the fourth quarter as displayed below:

(in thousands)	April 30, 2014	July 31, 2014
Fiscal 2015		
Accounts receivable, net	\$684,155	\$834,323
Deferred revenue, current and noncurrent	2,324,615	2,352,904

(in thousands)	April 30, 2013	July 31, 2013	October 31, 2013	January 31, 2014
Fiscal 2014				
Accounts receivable, net	\$502,609	\$599,543	\$604,045	\$1,360,837
Deferred revenue, current and noncurrent	1,733,160	1,789,648	1,734,619	2,522,115

(in thousands)	April 30, 2012	July 31, 2012	October 31, 2012	January 31, 2013
Fiscal 2013				
Accounts receivable, net	\$371,395	\$446,917	\$418,590	\$872,634
Deferred revenue, current and noncurrent	1,334,716	1,337,184	1,291,703	1,862,995



## Table of Contents

### Unbilled Deferred Revenue

The deferred revenue balance on our consolidated balance sheet does not represent the total contract value of annual or multi-year, non-cancelable subscription agreements. Unbilled deferred revenue represents future billings under our subscription agreements that have not been invoiced and, accordingly, are not recorded in deferred revenue. Unbilled deferred revenue was approximately \$5.0 billion as of July 31, 2014 and approximately \$4.5 billion as of January 31, 2014. Our typical contract length has grown and is now between 12 and 36 months. We expect that the amount of unbilled deferred revenue will change from quarter to quarter for several reasons, including the specific timing and duration of large customer subscription agreements, varying billing cycles of subscription agreements, the specific timing of customer renewals, foreign currency fluctuations, the timing of when unbilled deferred revenue is to be recognized as revenue, and changes in customer financial circumstances. For multi-year subscription agreements billed annually, the associated unbilled deferred revenue is typically high at the beginning of the contract period, zero just prior to renewal, and increases if the agreement is renewed. Low unbilled deferred revenue attributable to a particular subscription agreement is often associated with an impending renewal and may not be an indicator of the likelihood of renewal or future revenue from such customer. Accordingly, we expect that the amount of aggregate unbilled deferred revenue will change from year-to-year depending in part upon the number and dollar amount of subscription agreements at particular stages in their renewal cycle. Such fluctuations are not a reliable indicator of future revenues. Unbilled deferred revenue does not include minimum revenue commitments from indirect sales channels, as we recognize revenue, deferred revenue, and any unbilled deferred revenue upon sell-through to an end user customer.

### Cost of Revenues and Operating Expenses

**Cost of Revenues.** Cost of subscription and support revenues primarily consists of expenses related to hosting our service and providing support, the costs of data center capacity, depreciation or operating lease expense associated with computer equipment and software, allocated overhead and amortization expense associated with capitalized software related to our services and acquired developed technologies. We allocate overhead such as information technology infrastructure, rent and occupancy charges based on headcount. Employee benefit costs and taxes are allocated based upon a percentage of total compensation expense. As such, general overhead expenses are reflected in each cost of revenue and operating expense category. Cost of professional services and other revenues consists primarily of employee-related costs associated with these services, including stock-based expenses, the cost of subcontractors and allocated overhead. The cost of providing professional services is significantly higher as a percentage of the related revenue than for our enterprise cloud computing subscription service due to the direct labor costs and costs of subcontractors.

We intend to continue to invest additional resources in our enterprise cloud computing services. For example, we have invested in additional database software and we plan to open additional data centers and expand our current data centers in the future. Additionally, as we acquire new businesses and technologies, the amortization expense associated with this activity will be included in cost of revenues. The timing of these additional expenses will affect our cost of revenues, both in terms of absolute dollars and as a percentage of revenues, in the affected periods.

**Research and Development.** Research and development expenses consist primarily of salaries and related expenses, including stock-based expenses, the costs of our development and test data center and allocated overhead. We continue to focus our research and development efforts on adding new features and services, integrating acquired technologies, increasing the functionality and security and enhancing the ease of use of our enterprise cloud computing services. Our proprietary, scalable and secure multi-tenant architecture enables us to provide all of our customers with a service based on a single version of our application. As a result, we do not have to maintain multiple versions, which enables us to have relatively lower research and development expenses as compared to traditional enterprise software companies.

We expect that in the future, research and development expenses will increase in absolute dollars and may increase as a percentage of total revenues as we invest in building the necessary employee and system infrastructure required to support the development of new, and improve existing, technologies and the integration of acquired businesses and technologies.

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

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



Table of Contents

**General and Administrative.** General and administrative expenses consist of salaries and related expenses, including stock-based expenses, for finance and accounting, legal, internal audit, human resources and management information systems personnel, legal costs, professional fees, other corporate expenses and allocated overhead. We expect that in the future, general and administrative expenses will increase in absolute dollars as we invest in our infrastructure and we incur additional employee related costs, professional fees and insurance costs related to the growth of our business and international expansion. We expect general and administrative costs as a percentage of total revenues to either remain flat or decrease for the next several quarters.

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

During the six months ended July 31, 2014, we recognized stock-based expense of \$273.5 million. As of July 31, 2014, the aggregate stock compensation remaining to be amortized to costs and expenses over a weighted-average period of 2.3 years was \$1.1 billion. We expect this stock compensation balance to be amortized as follows: \$274.7 million during the remaining six months of fiscal 2015; \$405.9 million during fiscal 2016; \$265.5 million during fiscal 2017; \$140.8 million during fiscal 2018 and \$12.2 million during fiscal 2019. The expected amortization reflects only outstanding stock awards as of July 31, 2014 and assumes no forfeiture activity. We expect to continue to issue stock-based awards to our employees in future periods.

**Amortization of Purchased Intangibles from Business Combinations.** Our cost of revenues and operating expenses include amortization of acquisition-related intangible assets, such as the amortization of the cost associated with an acquired company's research and development efforts, trade names, customer lists and customer relationships. We expect this expense to increase as we acquire more companies.

**Critical Accounting Estimates**

Our condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States. The preparation of these condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, costs and expenses, and related disclosures. On an ongoing basis, we evaluate our estimates and assumptions. Our actual results may differ from these estimates under different assumptions or conditions.

We believe that of our significant accounting policies, which are described in Note 1 "Summary of Business and Significant Accounting Policies" to our condensed consolidated financial statements, the following accounting policies involve a greater degree of judgment and complexity. Accordingly, these are the policies we believe are the most critical to aid in fully understanding and evaluating our condensed consolidated financial condition and results of operations.

**Revenue Recognition.** We derive our revenues from two sources: (1) subscription revenues, which are comprised of subscription fees from customers accessing our enterprise cloud computing services and from customers purchasing additional support beyond the standard support that is included in the basic subscription fee; and (2) related professional services such as process mapping, project management, implementation services and other revenue. "Other revenue" consists primarily of training fees.

We commence revenue recognition when all of the following conditions are satisfied:

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

Our subscription service arrangements are non-cancelable and do not contain refund-type provisions.

## Table of Contents

### Subscription and Support Revenues

Subscription and support revenues are recognized ratably over the contract terms beginning on the commencement date of each contract, which is the date our service is made available to customers. Amounts that have been invoiced are recorded in accounts receivable and in deferred revenue or revenue, depending on whether the revenue recognition criteria have been met.

### Professional Services and Other Revenues

The majority of our professional services contracts are on a time and material basis. When these services are not combined with subscription revenues as a single unit of accounting, as discussed below, these revenues are recognized as the services are rendered for time and material contracts, and when the milestones are achieved and accepted by the customer for fixed price contracts. Training revenues are recognized after the services are performed.

### Multiple Deliverable Arrangements

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

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

For certain professional services, we have established VSOE as a consistent number of standalone sales of this deliverable have been priced within a reasonably narrow range. We have not established VSOE for our subscription services due to lack of pricing consistency, the introduction of new services and other factors. Accordingly, we use our BESP to determine the relative selling price.

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

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

Deferred revenue that will be recognized during the succeeding twelve month period is recorded as current deferred revenue and the remaining portion is recorded as noncurrent.

**Deferred Commissions.** We defer commission payments to our direct sales force. The commissions are deferred and amortized to sales expense over the non-cancelable terms of the related subscription contracts with our customers, which are typically 12 to 36 months. The commission payments, which are paid in full the month after the customer's

service commences, are a direct and incremental cost of the revenue arrangements. The deferred commission amounts are recoverable through the future revenue streams under the non-cancelable customer contracts. We believe this is the preferable method of accounting as the commission charges are so closely related to the revenue from the non-cancelable customer contracts that they should be recorded as an asset and charged to expense over the same period that the subscription revenue is recognized.

Table of Contents

During the six months ended July 31, 2014, we deferred \$106.7 million of commission expenditures and we amortized \$121.2 million to sales expense. During the same period a year ago, we deferred \$62.8 million of commission expenditures and we amortized \$91.9 million to sales expense. Deferred commissions on our condensed consolidated balance sheets totaled \$310.5 million at July 31, 2014 and \$324.9 million at January 31, 2014.

**Capitalized Internal-Use Software Costs.** We are required to follow the guidance of Accounting Standards Codification 350 (“ASC 350”), Intangibles- Goodwill and Other in accounting for the cost of computer software developed for internal-use and the accounting for web-based product development costs. ASC 350 requires companies to capitalize qualifying computer software costs, which are incurred during the application development stage, and amortize these costs on a straight-line basis over the estimated useful life of the respective asset. We deliver our enterprise cloud computing solutions as a service via all the major Internet browsers and on leading major mobile device operating systems. As a result of this software as a service delivery model, we believe we have larger capitalized costs as compared to traditional enterprise software companies as they are required to use a different accounting standard.

Costs related to preliminary project activities and post implementation activities are expensed as incurred. Internal-use software is amortized on a straight-line basis over its estimated useful life. We evaluate the useful lives of these assets on an annual basis and test for impairment whenever events or changes in circumstances occur that could impact the recoverability of these assets.

**Goodwill and Long-Lived Assets.** We make estimates, assumptions, and judgments when valuing goodwill and other intangible assets in connection with the initial purchase price allocation of an acquired entity, as well as when evaluating the recoverability of our goodwill and other intangible assets on an ongoing basis. These estimates are based upon a number of factors, including historical experience, market conditions, and information obtained from the management of acquired companies. Critical estimates in valuing certain intangible assets include, but are not limited to, historical and projected attrition rates, anticipated growth in revenue from the acquired customers and acquired technology, and the expected use of the acquired assets. These factors are also considered in determining the useful life of acquired intangible assets. The amounts and useful lives assigned to identified intangible assets impacts the amount and timing of future amortization expense.

The value of our goodwill and intangible assets could be impacted by future adverse changes such as, but not limited to: a substantial decline in our market capitalization; an adverse action or assessment by a regulator; and unanticipated competition.

We evaluate and test the recoverability of our goodwill for impairment at least annually during the fourth quarter or more often if and when circumstances indicate that goodwill may not be recoverable. Each period we evaluate the estimated remaining useful life of our intangible assets and whether events or changes in circumstances warrant a revision to the remaining period of amortization. We evaluate long-lived assets, such as property and equipment, and purchased intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Such events or changes in circumstances include, but are not limited to, a significant decrease in the fair value of the underlying asset, a significant decrease in the benefits realized from the acquired assets, difficulty and delays in integrating the business or a significant change in the operations of the acquired assets or use of an asset. A long-lived asset is considered impaired if its carrying amount exceeds the estimated future undiscounted cash flows the asset is expected to generate. If a long-lived asset is considered to be impaired, the impairment to be recognized is the amount by which the carrying amount of the asset exceeds the fair value of the asset or asset group.

**Business Combinations.** Accounting for business combinations requires us to make significant estimates and assumptions, especially at the acquisition date with respect to tangible and intangible assets acquired and liabilities assumed and pre-acquisition contingencies. We use our best estimates and assumptions to accurately assign fair value to the tangible and intangible assets acquired and liabilities assumed at the acquisition date.

Examples of critical estimates in valuing certain of the intangible assets and goodwill we have acquired include but are not limited to:

- future expected cash flows from subscription and support contracts, professional services contracts, other customer contracts and acquired developed technologies and patents;

the acquired company's trade name, trademark and existing customer relationship, as well as assumptions about the period of time the acquired trade name and trademark will continue to be used in our offerings; uncertain tax positions and tax related valuation allowances assumed; and discount rates.

Table of Contents

Unanticipated events and circumstances may occur that may affect the accuracy or validity of such assumptions, estimates or actual results.

**Stock-Based Options and Awards.** We recognize the fair value of our stock options and awards on a straight-line basis over the requisite service period of the option or award which is the vesting term of generally four years for stock options and restricted stock awards and one year for shares issued pursuant to our Employee Stock Purchase Plan (“ESPP”). The fair value of each option or ESPP share or stock purchase right is estimated on the date of grant using the Black-Scholes option pricing model. The estimated forfeiture rate applied is based on historical forfeiture rates. We evaluate the forfeiture rates at least annually, or when events or circumstances indicate a change may be needed. This may cause a fluctuation in our stock-based compensation in the period of change. Inputs into the Black-Scholes option pricing model include:

- The estimated life for the stock options which is estimated based on an actual analysis of expected life. The estimated life for shares issued pursuant to our ESPP is based on the two purchase periods within the 12 month offering period;

- The risk free interest rate which is based on the rate for a U.S. government security with the same estimated life at the time of the option grant and the stock purchase rights;

The future stock price volatility which is estimated considering both our observed option-implied volatilities and our historical volatility calculations. We believe this is the best estimate of the expected volatility over the expected life of our stock options and stock purchase rights; and

- The probability of performance conditions, if any, that affect the vesting of certain awards being achieved. Expense is only recognized for those shares expected to vest.

**Income Taxes.** We use the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on temporary differences between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the condensed consolidated statements of operations in the period that includes the enactment date. At each of the interim financial reporting periods, we compute our tax provision by applying an estimated annual effective tax rate to year to date ordinary income and adjust the provision for discrete tax items recorded in the same period. The estimated annual effective tax rate at each interim period represents the best estimate based on evaluations of possible future transactions and may be subject to subsequent refinement or revision.

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

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

Our tax provision could be adversely affected by changes in the mix of earnings and losses in countries with differing statutory tax rates, certain non-deductible expenses, changes in the valuation of deferred tax assets and liabilities and our ability to utilize them, changes in tax laws, including fundamental changes to tax laws applicable to corporate multinationals that may be considered by the United States and many countries in the European Union, changes in accounting principles, adverse results of tax examinations as well as changes in excess tax benefits related to exercises

and vesting of stock-based compensation that are allocated directly to stockholders' equity.

38

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Table of Contents

Strategic Investments. We report our investments in non-marketable equity and debt securities, which consist of minority equity and debt investments in privately-held companies, at cost or fair value when an event or circumstance indicates an other-than-temporary decline in value has occurred. Management evaluates financial results, earnings trends, technology milestones and subsequent financing of these companies, as well as the general market conditions to identify indicators of other-than-temporary impairment.

## Results of Operations

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

	Three Months Ended July 31,		Six Months Ended July 31,	
	2014	2013	2014	2013
Revenues:				
Subscription and support	\$ 1,232,587	\$ 902,844	\$ 2,379,893	\$ 1,745,065
Professional services and other	85,964	54,250	165,430	104,662
Total revenues	1,318,551	957,094	2,545,323	1,849,727
Cost of revenues:				
Subscription and support	218,918	160,908	427,865	314,458
Professional services and other	88,913	56,809	172,271	112,253
Total cost of revenues	307,831	217,717	600,136	426,711
Gross profit	1,010,720	739,377	1,945,187	1,423,016
Operating expenses:				
Research and development	203,109	148,079	391,467	280,018
Marketing and sales	671,958	480,621	1,311,313	947,111
General and administrative	169,087	150,534	331,182	280,284
Total operating expenses	1,044,154	779,234	2,033,962	1,507,413
Loss from operations	(33,434 )	(39,857 )	(88,775 )	(84,397 )
Investment income	2,655	4,387	4,433	7,741
Interest expense	(18,314 )	(19,656 )	(38,673 )	(31,539 )
Other expense	(3,876 )	(1,678 )	(14,723 )	(2,552 )
Loss before benefit from (provision for) income taxes	(52,969 )	(56,804 )	(137,738 )	(110,747 )
Benefit from (provision for) income taxes (1)	(8,119 )	133,407	(20,261 )	119,629
Net income (loss)	\$(61,088 )	\$76,603	\$(157,999 )	\$8,882

(1) The three and six months ended July 31, 2013 include a \$128.8 million tax benefit recorded during the three months ended July 31, 2013 as a result of the partial release of our tax valuation allowance.



Table of Contents

Cost of revenues and marketing and sales expenses include the following amounts related to amortization of purchased intangibles from business combinations (in thousands):

	Three Months Ended July 31,		Six Months Ended July 31,	
	2014	2013	2014	2013
Cost of revenues	\$21,271	\$22,550	\$49,943	\$43,855
Marketing and sales	14,648	4,476	29,613	6,936

Cost of revenues and operating expenses include the following amounts related to stock-based awards (in thousands):

	Three Months Ended July 31,		Six Months Ended July 31,	
	2014	2013	2014	2013
Cost of revenues	\$12,977	\$9,981	\$24,787	\$20,659
Research and development	33,112	26,032	60,396	50,461
Marketing and sales	70,485	56,133	137,618	115,935
General and administrative	25,837	18,330	50,702	38,150

Revenues by geography were as follows (in thousands):

	Three Months Ended July 31,		Six Months Ended July 31,	
	2014	2013	2014	2013
Americas	\$940,946	\$678,535	\$1,817,323	\$1,309,643
Europe	246,532	173,705	477,342	336,531
Asia Pacific	131,073	104,854	250,658	203,553
	\$1,318,551	\$957,094	\$2,545,323	\$1,849,727

Americas revenue attributed to the United States was approximately 94 percent and 96 percent for the three months ended July 31, 2014 and 2013, respectively, and approximately 94 percent and 95 percent for the six months ended July 31, 2014 and 2013, respectively. No other country represented more than ten percent of total revenue during the three and six months ended July 31, 2014 and 2013.

Table of Contents

The following tables set forth selected condensed consolidated statements of operations data for each of the periods indicated as a percentage of total revenues:

	Three Months Ended July 31,		Six Months Ended July 31,		
	2014	2013	2014	2013	
Revenues:					
Subscription and support	93	% 94	% 94	% 94	%
Professional services and other	7	6	6	6	
Total revenues	100	100	100	100	
Cost of revenues:					
Subscription and support	17	17	17	17	
Professional services and other	6	6	7	6	
Total cost of revenues	23	23	24	23	
Gross profit	77	77	76	77	
Operating expenses:					
Research and development	16	15	15	15	
Marketing and sales	51	50	51	51	
General and administrative	13	16	13	15	
Total operating expenses	80	81	79	81	
Loss from operations	(3 )	(4 )	(3 )	(4 )	)
Investment income	0	0	0	0	
Interest expense	(1 )	(2 )	(1 )	(2 )	)
Other expense	0	0	(1 )	0	)
Loss before benefit from (provision for) income taxes	(4 )	(6 )	(5 )	(6 )	)
Benefit from (provision for) income taxes	(1 )	14	(1 )	6	)
Net income (loss)	(5 )	% 8	% (6	)% 0	%
	Three Months Ended July 31,		Six Months Ended July 31,		
	2014	2013	2014	2013	
Amortization of purchased intangibles:					
Cost of revenues	2	% 2	% 2	% 2	%
Marketing and sales	1	0	1	0	
	Three Months Ended July 31,		Six Months Ended July 31,		
	2014	2013	2014	2013	
Stock-based awards:					
Cost of revenues	1	% 1	% 1	% 1	%
Research and development	3	3	2	3	
Marketing and sales	5	6	5	6	
General and administrative	2	2	2	2	

Table of Contents

	Three Months Ended July 31,		Six Months Ended July 31,		
	2014	2013	2014	2013	
Revenues by geography:					
Americas	71	% 71	% 71	% 71	%
Europe	19	18	19	% 18	%
Asia Pacific	10	11	10	% 11	%
	100	% 100	% 100	% 100	%

	Three Months Ended July 31, 2014 compared to Three Months Ended July 31, 2013		Three Months Ended July 31, 2013 compared to Three Months Ended July 31, 2012	
Revenue constant currency growth rates (as compared to the comparable prior periods)				
Americas	39	%	34	%
Europe	36	%	34	%
Asia Pacific	27	%	19	%
Total growth	37	%	32	%

We present constant currency information to provide a framework for assessing how our underlying business performed excluding the effect of foreign currency rate fluctuations. To present this information, current and comparative prior period results for entities reporting in currencies other than United States dollars are converted into United States dollars at the weighted average exchange rate for the quarter being compared to for growth rate calculations presented, rather than the actual exchange rates in effect during that period.

Table of Contents

## Three Months Ended July 31, 2014 and 2013

## Revenues.

(in thousands)	Three Months Ended July 31,		Variance		
	2014	2013	Dollars	Percent	
Subscription and support	\$1,232,587	\$902,844	\$329,743	37	%
Professional services and other	85,964	54,250	31,714	58	%
Total revenues	\$1,318,551	\$957,094	\$361,457	38	%

Total revenues were \$1.3 billion for the three months ended July 31, 2014, compared to \$957.1 million during the same period a year ago, an increase of \$361.5 million, or 38 percent. On a constant currency basis, total revenues grew 37 percent. Subscription and support revenues were \$1,232.6 million, or 93 percent of total revenues, for the three months ended July 31, 2014, compared to \$902.8 million, or 94 percent of total revenues, during the same period a year ago, an increase of \$329.7 million, or 37 percent. The increase in subscription and support revenues was primarily caused by volume-driven increases from new business, which includes new customers, upgrades and additional subscriptions from existing customers. The acquisition of ExactTarget on July 12, 2013 also contributed to the increase in subscription and support revenues. The decline in our attrition rate played a secondary role in the increase in subscription and support revenues. We continue to invest in a variety of customer programs and initiatives, which, along with increasing enterprise adoption, have helped reduce our attrition rate. The net price per user per month for our three primary offerings, Professional Edition, Enterprise Edition and Unlimited Edition, varies from period to period, but has remained within a consistent range over the past eight quarters. Changes in the net price per user per month has not been a significant driver of revenue growth for the periods presented. Professional services and other revenues were \$86.0 million, or seven percent of total revenues, for the three months ended July 31, 2014, compared to \$54.3 million, or six percent of total revenues, for the same period a year ago, an increase of \$31.7 million, or 58 percent. The increase in professional services and other revenues was due primarily to the higher demand for services from an increased number of customers and the acquisition of ExactTarget.

Revenues in Europe and Asia Pacific accounted for \$377.6 million, or 29 percent of total revenues, for the three months ended July 31, 2014, compared to \$278.6 million, or 29 percent of total revenues, during the same period a year ago, an increase of \$99.0 million, or 36 percent. The increase in revenues outside of the Americas was the result of the increasing acceptance of our service, our focus on marketing our services internationally, additional resources and reduced attrition rates as a result of the reasons stated above. Revenues outside of the Americas benefited from the strengthening of the major international currencies relative to the U.S. dollar, which increased aggregate international revenues by \$8.9 million compared to the same period a year ago.

## Cost of Revenues.

(in thousands)	Three Months Ended July 31,		Variance		
	2014	2013	Dollars		
Subscription and support	\$218,918	\$160,908	\$58,010		
Professional services and other	88,913	56,809	32,104		
Total cost of revenues	\$307,831	\$217,717	\$90,114		
Percent of total revenues	23	% 23		%	

Cost of revenues was \$307.8 million, or 23 percent of total revenues, for the three months ended July 31, 2014, compared to \$217.7 million, or 23 percent of total revenues, during the same period a year ago, an increase of \$90.1 million. The increase in absolute dollars was primarily due to an increase of \$37.0 million in employee-related costs, an increase of \$3.0 million in stock-based expenses, an increase of \$23.4 million in service delivery costs, primarily due to our efforts to increase data center capacity, an increase of \$9.1 million in professional and outside services, an increase of \$11.5 million in depreciation and amortization expenses and an increase of \$3.6 in allocated overhead. We have increased our headcount by 25 percent since July 31, 2013 to meet the higher demand for services from our customers. In July 2013, we acquired ExactTarget, which contributed to the increase in cost of revenues for the three months ended July 31, 2014 as compared to the same period a year ago. In June 2013, we entered into a large capital lease agreement for software for a period of nine years, which consists of the contractual term of six years and a renewal option of three years. The capitalized portion is being depreciated over the estimated useful life of the

software, which is nine years. A portion of the depreciation expense on this asset was allocated to cost of revenues which is included in the amount above. We intend to continue to invest additional resources in our enterprise

43

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Table of Contents

cloud computing services and data center capacity. Additionally, the amortization of purchased intangible assets will increase as we acquire additional businesses and technologies. We also plan to add additional employees in our professional services group to facilitate the adoption of our services. The timing of these expenses will affect our cost of revenues, both in terms of absolute dollars and as a percentage of revenues in future periods.

## Research and Development.

(in thousands)	Three Months Ended July 31,		Variance
	2014	2013	Dollars
Research and development	\$203,109	\$148,079	\$55,030
Percent of total revenues	16	% 15	%

Research and development expenses were \$203.1 million, or 16 percent of total revenues, for the three months ended July 31, 2014, compared to \$148.1 million, or 15 percent of total revenues, during the same period a year ago, an increase of \$55.0 million. The increase in absolute dollars was primarily due to an increase of \$41.9 million in employee-related costs, an increase of \$7.1 million in stock-based expenses, an increase of \$3.9 million in our development and test data center, and an increase in depreciation and amortization expenses. We increased our research and development headcount by 15 percent since July 31, 2013 in order to improve and extend our service offerings and develop new technologies. In July 2013, we acquired ExactTarget, which contributed to the increase in research and development expenses for the three months ended July 31, 2014 as compared to the same period a year ago. In June 2013, we entered into a large capital lease agreement for software for a period of nine years, which consists of the contractual term of six years and a renewal option of three years. A portion of the depreciation expense on this asset was allocated to research and development. We expect that research and development expenses will increase in absolute dollars and may increase as a percentage of revenues in future periods as we continue to add employees and invest in technology to support the development of new, and improve existing, technologies and the integration of acquired technologies.

## Marketing and Sales.

(in thousands)	Three Months Ended July 31,		Variance
	2014	2013	Dollars
Marketing and sales	\$671,958	\$480,621	\$191,337
Percent of total revenues	51	% 50	%

Marketing and sales expenses were \$672.0 million, or 51 percent of total revenues, for the three months ended July 31, 2014, compared to \$480.6 million, or 50 percent of total revenues, during the same period a year ago, an increase of \$191.3 million. The increase in absolute dollars was primarily due to increases of \$134.9 million in employee-related costs, including amortization of deferred commissions, \$14.4 million in stock-based expenses, \$18.5 million in advertising expenses, \$10.2 million related to the amortization of purchased intangible assets and \$8.3 million in allocated overhead. Our marketing and sales headcount increased by 24 percent since July 31, 2013. The increase in headcount was primarily attributable to hiring additional sales personnel to focus on adding new customers and increasing penetration within our existing customer base. In July 2013, we acquired ExactTarget, which contributed to the increase in marketing and sales expenses for the three months ended July 31, 2014 as compared to the same period a year ago.

## General and Administrative.

(in thousands)	Three Months Ended July 31,		Variance
	2014	2013	Dollars
General and administrative	\$169,087	\$150,534	\$18,553
Percent of total revenues	13	% 16	%

General and administrative expenses were \$169.1 million, or 13 percent of total revenues, for the three months ended July 31, 2014, compared to \$150.5 million, or 16 percent of total revenues, during the same period a year ago, an increase of \$18.6 million. The increase was primarily due to increases of \$15.4 million in employee-related costs and increases of \$7.5 million in stock-based compensation, offset by reductions in transactions costs that were incurred in the three months ended July 31, 2013 as a result of the acquisition of ExactTarget. Our general and administrative headcount increased by 10 percent since July 31, 2013 as we added personnel to support our growth. In July 2013, we

acquired ExactTarget, which contributed to

44

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Table of Contents

the increase in general and administrative expenses for the three months ended July 31, 2014 as compared to the same period a year ago.

Loss from operations.

(in thousands)	Three Months Ended July 31,		Variance
	2014	2013	Dollars
Loss from operations	\$ (33,434 )	\$ (39,857 )	\$ 6,423
Percent of total revenues	(3 )%	(4 )%	

Loss from operations for the three months ended July 31, 2014 was \$33.4 million and included \$142.4 million of stock-based expenses and \$35.9 million of amortization of purchased intangibles. During the same period a year ago, loss from operations was \$39.9 million and included \$110.5 million of stock-based expenses and \$27.0 million of amortization of purchased intangibles.

Investment income.

(in thousands)	Three Months Ended July 31,		Variance
	2014	2013	Dollars
Investment income	\$ 2,655	\$ 4,387	\$ (1,732 )
Percent of total revenues	0	0	%

Investment income consists of income on our cash and marketable securities balances. Investment income was \$2.7 million for the three months ended July 31, 2014 and was \$4.4 million during the same period a year ago. The decrease was primarily due to the decrease in marketable securities in July 2013 as a result of our use of such securities to provide cash for our acquisition of ExactTarget.

Interest expense.

(in thousands)	Three Months Ended July 31,		Variance
	2014	2013	Dollars
Interest expense	\$ (18,314 )	\$ (19,656 )	\$ 1,342
Percent of total revenues	(1 )%	(2 )%	

Interest expense consists of interest on our convertible senior notes, capital leases and term loan. Interest expense, net of interest costs capitalized, was \$18.3 million for the three months ended July 31, 2014 and was \$19.7 million during the same period a year ago. The decrease was primarily due to the reduced principal balance on our 0.75% convertible senior notes as a result of note conversions since July 31, 2013.

Other expense.

(in thousands)	Three Months Ended July 31,		Variance
	2014	2013	Dollars
Other expense	\$ (3,876 )	\$ (1,678 )	\$ (2,198 )
Percent of total revenues	0	0	%

Other expense primarily consists of non-operating costs such as foreign currency transaction gains and losses, costs associated with real estate transactions and losses on derecognition of debt. Other expense for the three months ended July 31, 2014 as compared to the same period a year ago, increased primarily due to increases in costs associated with real estate transactions.



Table of Contents

Benefit from (provision for) income taxes.

(in thousands)	Three Months Ended July 31,		Variance
	2014	2013	Dollars
Benefit from (provision for) income taxes	\$(8,119	) \$133,407	\$(141,526
Effective tax rate	(15	)% 235	%

We recognized a tax provision of \$8.1 million on a pretax loss of \$53.0 million, which resulted in a negative effective tax rate of 15 percent for the three months ended July 31, 2014. We had a tax provision primarily due to income taxes in profitable jurisdictions outside the U.S.

We recorded a tax benefit of \$133.4 million for the three months ended July 31, 2013, which resulted in an effective tax rate of 235 percent. Included in the tax benefit was \$128.8 million of discrete tax benefit from a partial release of the valuation allowance on our deferred tax assets. Due to the acquisition of ExactTarget, we established a deferred tax liability for the book-tax basis difference related to purchased intangibles. The net deferred tax liability from the acquisition of ExactTarget provided an additional source of income to support the realizability of our pre-existing deferred tax assets and as a result, we recorded a partial release of our valuation allowance.

Six Months Ended July 31, 2014 and 2013

Revenues.

(in thousands)	Six Months Ended July 31,		Variance	
	2014	2013	Dollars	Percent
Subscription and support	\$2,379,893	\$1,745,065	\$634,828	36
Professional services and other	165,430	104,662	60,768	58
Total revenues	\$2,545,323	\$1,849,727	\$695,596	38

Total revenues were \$2.5 billion for the six months ended July 31, 2014, compared to \$1.8 billion during the same period a year ago, an increase of \$695.6 million, or 38 percent. On a constant currency basis, total revenues grew 37 percent. Subscription and support revenues were \$2.4 billion, or 94 percent of total revenues, for the six months ended July 31, 2014, compared to \$1.7 billion, or 94 percent of total revenues, during the same period a year ago, an increase of \$634.8 million, or 36 percent. The increase in subscription and support revenues was primarily caused by volume-driven increases from new business, which includes new customers, upgrades and additional subscriptions from existing customers. The acquisition of ExactTarget on July 12, 2013 also contributed to the increase in subscription and support revenues. The decline in our attrition rate played a secondary role in the increase in subscription and support revenues. We continue to invest in a variety of customer programs and initiatives, which, along with increasing enterprise adoption, have helped reduce our attrition rate. The net price per user per month for our three primary offerings, Professional Edition, Enterprise Edition and Unlimited Edition, varies from period to period, but has remained within a consistent range over the past eight quarters. Changes in the net price per user per month has not been a significant driver of revenue growth for the periods presented. Professional services and other revenues were \$165.4 million, or six percent percent of total revenues, for the six months ended July 31, 2014, compared to \$104.7 million, or six percent of total revenues, for the same period a year ago, an increase of \$60.8 million, or 58 percent. The increase in professional services and other revenues was due primarily to the higher demand for services from an increased number of customers and the acquisition of ExactTarget.

Revenues in Europe and Asia Pacific accounted for \$728.0 million, or 29 percent of total revenues, for the six months ended July 31, 2014, compared to \$540.1 million, or 29 percent of total revenues, during the same period a year ago, an increase of \$187.9 million, or 35 percent. The increase in revenues outside of the Americas was the result of the increasing acceptance of our service, our focus on marketing our services internationally, additional resources and reduced attrition rates as a result of the reasons stated above. Revenues outside of the Americas benefited from the strengthening of the major international currencies relative to the U.S. dollar, which increased aggregate international revenues by \$14.6 million compared to the same period a year ago.



Table of Contents

## Cost of Revenues.

(in thousands)	Six Months Ended July 31,		Variance
	2014	2013	Dollars
Subscription and support	\$427,865	\$314,458	\$113,407
Professional services and other	172,271	112,253	60,018
Total cost of revenues	\$600,136	\$426,711	\$173,425
Percent of total revenues	24	% 23	%

Cost of revenues was \$600.1 million, or 24 percent of total revenues, for the six months ended July 31, 2014, compared to \$426.7 million, or 23 percent of total revenues, during the same period a year ago, a increase of \$173.4 million. The increase in absolute dollars was primarily due to an increase of \$75.2 million in employee-related costs, an increase of \$4.1 million in stock-based expenses, an increase of \$40.5 million in service delivery costs, primarily due to our efforts to increase data center capacity, an increase of \$35.4 million in depreciation and amortization expenses, \$6.1 million of which related to the amortization of purchased intangible assets, and an increase of \$9.8 million in allocated overhead. We have increased our headcount by 25 percent since July 31, 2013 to meet the higher demand for services from our customers. In July 2013, we acquired ExactTarget, which contributed to the increase in cost of revenues for the six months ended July 31, 2014 as compared to the same period a year ago. In June 2013, we entered into a large capital lease agreement for software for a period of nine years, which consists of the contractual term of six years and a renewal option of three years. The capitalized portion is being depreciated over the estimated useful life of the software, which is nine years. A portion of the depreciation expense on this asset was allocated to cost of revenues which is included in the amount above. We expect the costs associated with this software agreement to increase slightly in future fiscal years. We intend to continue to invest additional resources in our enterprise cloud computing services and data center capacity. Additionally, the amortization of purchased intangible assets will increase as we acquire additional businesses and technologies. We also plan to add additional employees in our professional services group to facilitate the adoption of our services. The timing of these expenses will affect our cost of revenues, both in terms of absolute dollars and as a percentage of revenues in future periods.

## Research and Development.

(in thousands)	Six Months Ended July 31,		Variance
	2014	2013	Dollars
Research and development	\$391,467	\$280,018	\$111,449
Percent of total revenues	15	% 15	%

Research and development expenses were \$391.5 million, or 15 percent of total revenues, for the six months ended July 31, 2014, compared to \$280.0 million, or 15 percent of total revenues, during the same period a year ago, an increase of \$111.4 million. The increase in absolute dollars was primarily due to an increase of \$81.2 million in employee-related costs, an increase of \$9.9 million in stock-based expenses, an increase of \$8.6 million in our development and test data center, and an increase of \$6.1 million in depreciation and amortization expenses. We increased our research and development headcount by 15 percent since July 31, 2013 in order to improve and extend our service offerings and develop new technologies. In July 2013, we acquired ExactTarget, which contributed to the increase in research and development expenses for the six months ended July 31, 2014 as compared to the same period a year ago. In June 2013, we entered into a large capital lease agreement for software for a period of nine years, which consists of the contractual term of six years and a renewal option of three years. A portion of the depreciation expense on this asset was allocated to research and development. We expect that research and development expenses will increase in absolute dollars and may increase as a percentage of revenues in future periods as we continue to invest in additional employees and technology to support the development of new, and improve existing, technologies and the integration of acquired technologies.

Table of Contents

## Marketing and Sales.

(in thousands)	Six Months Ended July 31,		Variance
	2014	2013	Dollars
Marketing and sales	\$1,311,313	\$947,111	\$364,202
Percent of total revenues	51	% 51	%

Marketing and sales expenses were \$1,311.3 million, or 51 percent of total revenues, for the six months ended July 31, 2014, compared to \$947.1 million, or 51 percent of total revenues, during the same period a year ago, an increase of \$364.2 million. The increase in absolute dollars was primarily due to increases of \$263.7 million in employee-related costs, including amortization of deferred commissions, \$21.7 million in stock-based expenses, \$29.6 million in advertising expenses, \$22.7 million related to the amortization of purchased intangible assets and \$21.1 million in allocated overhead. Our marketing and sales headcount increased by 24 percent since July 31, 2013. The increase in headcount was primarily attributable to hiring additional sales personnel to focus on adding new customers and increasing penetration within our existing customer base. In July 2013, we acquired ExactTarget, which contributed to the increase in marketing and sales expenses for the six months ended July 31, 2014 as compared to the same period a year ago.

## General and Administrative.

(in thousands)	Six Months Ended July 31,		Variance
	2014	2013	Dollars
General and administrative	\$331,182	\$280,284	\$50,898
Percent of total revenues	13	% 15	%

General and administrative expenses were \$331.2 million, or 13 percent of total revenues, for the six months ended July 31, 2014, compared to \$280.3 million, or 15 percent of total revenues, during the same period a year ago, an increase of \$50.9 million. The increase was primarily due to increases of \$35.7 million in employee-related costs, \$12.6 million in stock-based expenses, and increases in allocated overhead. Our general and administrative headcount increased by 10 percent since July 31, 2013 as we added personnel to support our growth. In July 2013, we acquired ExactTarget, which contributed to the increase in general and administrative expenses for the six months ended July 31, 2014 as compared to the same period a year ago.

## Loss from operations.

(in thousands)	Six Months Ended July 31,		Variance
	2014	2013	Dollars
Loss from operations	\$(88,775 )	\$(84,397 )	\$(4,378 )
Percent of total revenues	(3 )%	(4 )%	%

Loss from operations for the six months ended July 31, 2014 was \$88.8 million and included \$273.5 million of stock-based expenses and \$79.6 million of amortization of purchased intangibles. During the same period a year ago, loss from operations was \$84.4 million and included \$225.2 million of stock-based expenses and \$50.8 million of amortization of purchased intangibles.

## Investment income.

(in thousands)	Six Months Ended July 31,		Variance
	2014	2013	Dollars
Investment income	\$4,433	\$7,741	\$(3,308 )
Percent of total revenues	0	% 0	%

Investment income consists of income on our cash and marketable securities balances. Investment income was \$4.4 million for the six months ended July 31, 2014 and was \$7.7 million during the same period a year ago. The decrease was primarily due to the decrease in marketable securities in July 2013 as a result of our use of such securities to provide cash for our acquisition of ExactTarget.

Table of Contents

## Interest expense.

(in thousands)	Six Months Ended July 31,		Variance
	2014	2013	Dollars
Interest expense	\$(38,673 )	\$(31,539 )	\$(7,134 )
Percent of total revenues	(1 )%	(2 )%	

Interest expense consists of interest on our convertible senior notes, capital leases and term loan. Interest expense, net of interest costs capitalized, was \$38.7 million for the six months ended July 31, 2014 and was \$31.5 million during the same period a year ago. The increase was primarily due to interest expense associated with the March 2013 issuance of \$1.15 billion of 0.25% convertible senior notes, the \$300.0 million term loan that was entered into in July 2013 and the large capital lease agreement for software which we entered into in June 2013.

## Other expense.

(in thousands)	Six Months Ended July 31,		Variance
	2014	2013	Dollars
Other expense	\$(14,723 )	\$(2,552 )	\$(12,171 )
Percent of total revenues	(1 )%	0 %	

Other expense primarily consists of foreign currency transaction gains and losses, costs associated with real estate transactions and losses on derecognition of debt. Other expense increased primarily due to the loss of approximately \$8.9 million on conversions of our convertible 0.75% senior notes that was recognized during the six months ended July 31, 2014. Increases in costs associated with real estate transactions also contributed to the increase in other expense for the six months ended July 31, 2014 as compared to the same period a year ago.

## Benefit from (provision for) income taxes.

(in thousands)	Six Months Ended July 31,		Variance
	2014	2013	Dollars
Benefit from (provision for) income taxes	\$(20,261 )	\$119,629	\$(139,890 )
Effective tax rate	(15)%	108 %	

We recognized a tax provision of \$20.3 million on a pretax loss of \$137.7 million, which resulted in a negative effective tax rate of 15 percent for the six months ended July 31, 2014. We had a tax provision primarily due to income taxes in profitable jurisdictions outside the U.S.

We recorded a tax benefit of \$119.6 million for the six months ended July 31, 2014, which resulted in an effective tax rate of 108 percent. Included in the tax benefit was \$128.8 million of discrete tax benefit from a partial release of the valuation allowance on our deferred tax assets. Due to the acquisition of ExactTarget, we established a deferred tax liability for the book-tax basis difference related to purchased intangibles. The net deferred tax liability from the acquisition of ExactTarget provided an additional source of income to support the realizability of our pre-existing deferred tax assets and as a result, we recorded a partial release of our valuation allowance.

## Liquidity and Capital Resources

At July 31, 2014, our principal sources of liquidity were cash, cash equivalents and marketable securities totaling \$1.7 billion and accounts receivable of \$834.3 million.

Net cash provided by operating activities was \$719.0 million during the six months ended July 31, 2014 and \$466.4 million during the same period a year ago. Cash provided by operating activities has historically been affected by the amount of net loss adjusted for non-cash expense items such as depreciation and amortization, amortization of purchased intangibles from business combinations, amortization of debt discount, and the expense associated with stock-based awards; the reclassification of excess tax benefits from employee stock plans to cash flows from financing activities; the timing of employee related costs

Table of Contents

including commissions and bonus payments; the timing of collections from our customers, which is our largest source of operating cash flows; and changes in working capital accounts.

Our working capital accounts consist of accounts receivables and prepaid assets and other current assets. Claims against working capital include accounts payable, accrued expenses and other current liabilities and our convertible notes. Our working capital may be impacted by factors in future periods, certain amounts and timing of which are seasonal, such as billings to customers for subscriptions and support services and the subsequent collection of those billings.

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

We generally invoice our customers for our subscription and services contracts in advance in annual installments. We typically issue renewal invoices in advance of the renewal service period, and depending on timing, the initial invoice for the subscription and services contract and the subsequent renewal invoice may occur in different quarters. Such invoice amounts are initially reflected in accounts receivable and deferred revenue, which is reflected on the balance sheet. The operating cash flow benefit of increased billing activity generally occurs in the subsequent quarter when we collect from our customers. As such, our first quarter has become our largest collections and operating cash flow quarter.

Net cash provided by operating activities during the six months ended July 31, 2014 increased \$252.6 million over the same period a year ago due to favorable changes in working capital accounts, primarily a decrease in accounts receivable. During the six months ended July 31, 2014, \$2.2 million of excess tax benefits from employee stock plans was reclassified to cash flows from financing activities, as compared to \$0.6 million during the same period a year ago.

Net cash used in investing activities was \$496.8 million during the six months ended July 31, 2014 and \$2.1 billion during the same period a year ago. The net cash used in investing activities during the six months ended July 31, 2014 primarily related to capital expenditures, including new office build-outs, investment of cash balances and strategic investments offset by proceeds from sales and maturities of marketable securities. Net cash used in investing activities during the six months ended July 31, 2014 decreased \$1.6 billion over the same period a year ago primarily due to the acquisitions of ExactTarget, Inc. and EdgeSpring, Inc. during the six months ended July 31, 2013 offset by an increase in purchases of marketable securities during the six months ended July 31, 2014.

Net cash used in financing activities was \$226.1 million during the six months ended July 31, 2014 as compared to net cash provided by financing activities of \$1.4 billion during the same period a year ago. Net cash used in financing activities during the six months ended July 31, 2014 consisted primarily of \$297.6 million in principal payments on our 0.75% convertible senior notes, \$50.9 million of principal payments on capital leases and \$15.0 million of principal payments on the term loan offset by \$135.2 million from proceeds from equity plans. Net cash flows used in financing activities during the six months ended July 31, 2014 changed \$1.7 billion from the same period a year ago primarily due to \$1.1 billion of proceeds from the issuance of convertible senior notes, \$84.8 million from proceeds from the issuance of warrants and \$298.5 million of proceeds from the term loan, net of loan fees during the six months ended July 31, 2013, offset by \$297.6 million in principal payments on our 0.75% convertible senior notes and an increase in principal payments on capital lease obligations during the six months ended July 31, 2014 and \$153.8 million for the purchase of hedges on the convertible notes during the six months ended July 31, 2013.

In January 2010, we issued \$575.0 million of 0.75% convertible senior notes due January 15, 2015 (the “0.75% Senior Notes”) and concurrently entered into convertible notes hedges (the “0.75% Note Hedges”) and separate warrant transactions (the “0.75% Warrants”). The 0.75% Senior Notes will mature on January 15, 2015, unless earlier converted. Upon conversion of any 0.75% Senior Notes, we will deliver cash up to the principal amount of the 0.75% Senior Notes and, with respect to any excess conversion value greater than the principal amount of the 0.75% Senior Notes, shares of our common stock, cash, or a combination of both.

As of July 31, 2014 the remaining principal balance of the 0.75% Senior Notes outstanding is \$271.3 million. During the quarter ending October 31, 2014, we will repay in cash an aggregate principal balance of at least \$89.6 million

related to additional conversion requests of our 0.75% Senior Notes received through the date of the filing of this Form 10-Q. The excess of the conversion value that is greater than the principal amount will be delivered in shares of our common stock for the majority of the conversion requests received to date. If our stock price continues to trade at a price exceeding 130% of the conversion price of \$21.34 per share applicable to our 0.75% Senior Notes, we may continue to see conversion requests on the 0.75% Senior Notes during fiscal 2015.

Table of Contents

In March 2013, we issued \$1.15 billion of 0.25% convertible senior notes due April 1, 2018 (the “0.25% Senior Notes”) and concurrently entered into convertible notes hedges (the “0.25% Note Hedges”) and separate warrant transactions (the “0.25% Warrants”). The 0.25% Senior Notes will mature on April 1, 2018, unless earlier converted. Upon conversion of any 0.25% Senior Notes, we will deliver cash up to the principal amount of the 0.25% Senior Notes and, with respect to any excess conversion value greater than the principal amount of the 0.25% Senior Notes, shares of our common stock, cash, or a combination of both.

The 0.25% Senior Notes will be convertible if during any 20 trading days during the 30 consecutive trading days of any fiscal quarter, our common stock trades at a price exceeding 130% of the conversion price of \$66.44 per share applicable to the 0.25% Senior Notes. The 0.25% Senior Notes have not yet been convertible at the holders’ option. The 0.25% Senior Notes are classified as a noncurrent liability on our condensed consolidated balance sheet as of July 31, 2014.

Our common stock did not trade at a price exceeding 130% of the conversion price of \$66.44 per share applicable to the 0.25% Senior Notes during the fiscal quarter ended July 31, 2014. Accordingly, the 0.25% Senior Notes will not be convertible at the holders’ option for the quarter ending October 31, 2014, and will remain classified as a noncurrent liability on our condensed consolidated balance sheet.

In July 2013, we entered into a credit agreement (the “Credit Agreement”) with Bank of America, N.A. and certain other lenders, which provides for a \$300.0 million term loan (the “Term Loan”) that matures on July 11, 2016 (the “Maturity Date”). The Term Loan bears interest at our option under either a LIBOR-based formula or a base rate formula, each as set forth in the Credit Agreement.

The Credit Agreement contains certain customary affirmative and negative covenants, including a consolidated leverage ratio covenant, a consolidated interest coverage ratio covenant, a limit on our ability to incur additional indebtedness, issue preferred stock or pay dividends, and certain other restrictions on our activities as defined in the Credit Agreement. We were in compliance with the Credit Agreement’s covenants as of July 31, 2014.

The weighted-average interest rate on the Term Loan was 1.8% for the three months ended July 31, 2014. As of July 31, 2014, the amount outstanding under the Term Loan was \$270.0 million. During the three months ended July 31, 2014, principal payments totaling \$7.5 million were made on the Term Loan and subsequent payments of \$7.5 million are due quarterly thereafter until the maturity date in July 2016 when the remaining outstanding principal amount is due.

Subsequent to July 31, 2014, we sold approximately 3.7 net acres of the undeveloped real estate that was classified as held for sale on our condensed consolidated balance sheet as of July 31, 2014, for a total of \$72.5 million. We will recognize a gain of \$7.8 million on the sale of this portion of our land and building improvements in the three months ended October 31, 2014. Separately, subsequent to July 31, 2014, we entered into an agreement to sell the remaining 1.5 net acres of undeveloped real estate that was classified as held for sale as of July 31, 2014. The sale of this portion of our undeveloped real estate is expected to close within twelve months and is subject to certain closing conditions. Our cash, cash equivalents and marketable securities are comprised primarily of corporate notes and other obligations, U.S. treasury securities, U.S. agency obligations, government obligations, collateralized mortgage obligations, mortgage backed securities, time deposits, money market mutual funds and municipal securities.

As of July 31, 2014, we have a total of \$64.1 million in letters of credit outstanding in favor of certain landlords for office space. To date, no amounts have been drawn against the letters of credit, which renew annually and expire at various dates through December 2030.

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

Our principal commitments consist of obligations under leases for office space and co-location facilities for data center capacity and our development and test data center, and computer equipment and software and furniture and fixtures. At July 31, 2014, the future non-cancelable minimum payments under these commitments were as follows (in thousands):





Table of Contents

	Capital Leases	Operating Leases	Financing Obligation, Building in Progress-Leased Facility
Fiscal Period:			
Remaining six months of fiscal 2015	\$ 19,206	\$ 116,503	\$ 0
Fiscal 2016	88,493	232,255	1,777
Fiscal 2017	99,806	207,389	16,877
Fiscal 2018	107,878	168,019	21,107
Fiscal 2019	112,506	172,056	21,551
Thereafter	201,233	1,218,423	274,512
Total minimum lease payments	629,122	\$ 2,114,645	\$ 335,824
Less: amount representing interest	(84,493 )		
Present value of capital lease obligations	\$ 544,629		

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

The financing obligation above represents the total obligation for our lease of approximately 445,000 rentable square feet of office space in San Francisco, California. As of July 31, 2014, \$73.2 million of the total obligation noted above was recorded to Financing obligation, building in progress - leased facility, which is included in "Other noncurrent liabilities" on the consolidated balance sheets.

On April 10, 2014, the Company entered into an office lease agreement to lease approximately 714,000 rentable square feet of an office building to be located in San Francisco, California. The lease payments associated with the lease will be approximately \$560.0 million over the 15.5 year term of the lease, beginning in the Company's first quarter of fiscal year 2018, which is reflected above under Operating Leases.

During the remaining six months of fiscal 2015 and in future fiscal years, we have made and expect to continue to make additional investments in our infrastructure to scale our operations and increase productivity. We plan to upgrade and/or replace various internal systems to scale with the overall growth of the Company. Additionally, we expect capital expenditures to be higher in absolute dollars and remain consistent as a percentage of total revenues in future periods as a result of continued office build-outs, other leasehold improvements and data center investments.

In the future, we may enter into arrangements to acquire or invest in complementary businesses or joint ventures, services and technologies, and intellectual property rights. We may be required to seek additional equity or debt financing. Additional funds may not be available on terms favorable to us or at all.

We believe our existing cash, cash equivalents and short-term marketable securities and cash provided by operating activities will be sufficient to meet our working capital, capital expenditure and debt repayment needs over the next 12 months.

#### Non-GAAP Financial Measures

Regulation S-K Item 10(e), "Use of Non-GAAP Financial Measures in Commission Filings," defines and prescribes the conditions for use of non-GAAP financial information. Our measures of non-GAAP gross profit, non-GAAP operating profit, non-GAAP net income and non-GAAP earnings per share each meet the definition of a non-GAAP financial measure.

#### Non-GAAP gross profit, Non-GAAP operating profit and Non-GAAP net income

We use the non-GAAP measures of non-GAAP gross profit, non-GAAP operating profit and non-GAAP net income to provide an additional view of operational performance by excluding non-cash expenses that are not directly related to performance in any particular period. In addition to our GAAP measures we use these non-GAAP measures when planning, monitoring, and evaluating our performance. We believe that these non-GAAP measures reflect our ongoing business in a manner that allows for meaningful period-to-period comparisons and analysis of trends in our business, as they exclude certain expenses and benefits. These items are excluded because the decisions which gave rise to them

are not made to increase revenue in a particular period, but are made for our long-term benefit over multiple periods and we are not able to change or affect these items in any particular period.

Table of Contents

We define non-GAAP net income as our total net income excluding the following components, which we believe are not reflective of our ongoing operational expenses. In each case, for the reasons set forth below, we believe that excluding the component provides useful information to investors and others in understanding and evaluating the impact of certain non-cash items to our operating results and future prospects in the same manner as us, in comparing financial results across accounting periods and to those of peer companies and to better understand the impact of these non-cash items on our gross margin and operating performance. Additionally, as significant, unusual or discrete events occur, the results may be excluded in the period in which the events occur.

**Stock-Based Expenses.** The Company's compensation strategy includes the use of stock-based compensation to attract and retain employees and executives. It is principally aimed at aligning their interests with those of our stockholders and at long-term employee retention, rather than to motivate or reward operational performance for any particular period. Thus, stock-based compensation expense varies for reasons that are generally unrelated to operational decisions and performance in any particular period.

**Amortization of Purchased Intangibles.** The Company views amortization of acquisition-related intangible assets, such as the amortization of the cost associated with an acquired company's research and development efforts, trade names, customer lists and customer relationships, as items arising from pre-acquisition activities determined at the time of an acquisition. While it is continually viewed for impairment, amortization of the cost of purchased intangibles is a static expense, one that is not typically affected by operations during any particular period.

**Amortization of Debt Discount.** Under GAAP, certain convertible debt instruments that may be settled in cash (or other assets) on conversion are required to be separately accounted for as liability (debt) and equity (conversion option) components of the instrument in a manner that reflects the issuer's non-convertible debt borrowing rate.

Accordingly, for GAAP purposes we are required to recognize imputed interest expense on the Company's \$575 million of convertible senior notes that were issued in a private placement in January 2010 and the Company's \$1.15 billion of convertible senior notes that were issued in a private placement in March 2013. The imputed interest rates were approximately 5.9% for the notes issued in January 2010 and approximately 2.5% for the notes issued in March 2013, while the coupon interest rates were 0.75% and 0.25%, respectively. The difference between the imputed interest expense and the coupon interest expense, net of the interest amount capitalized, is excluded from management's assessment of the Company's operating performance because management believes that this non-cash expense is not indicative of ongoing operating performance. Management believes that the exclusion of the non-cash interest expense provides investors an enhanced view of the Company's operational performance.

**Gains/Losses on Conversions of Debt.** Upon settlement of the Company's convertible senior notes, we attribute the fair value of the consideration transferred to the liability and equity components of the convertible senior notes. The difference between the fair value of consideration attributed to the liability component and the carrying value of the liability as of settlement date is recorded as a non-cash gain or loss on the statement of operations. Management believes that the exclusion of the non-cash gain/loss provides investors an enhanced view of the company's operational performance.

**Income Tax Effects and Adjustments.** During fiscal 2014, the Company's non-GAAP tax provision excludes the tax effects of expense items described above and certain tax items not directly related to the current fiscal year's ordinary operating results. Examples of such tax items include, but are not limited to, changes in the valuation allowance related to deferred tax assets, certain acquisition-related costs and unusual or infrequently occurring items. Management believes the exclusion of these income tax adjustments provides investors with useful supplemental information about the Company's operational performance. During fiscal 2015, the Company began to compute and utilize a fixed long-term projected non-GAAP tax rate in order to provide better consistency across the interim reporting periods by eliminating the effects of non-recurring and period-specific items such as changes in the tax valuation allowance and tax effects of acquisitions-related costs, since each of these can vary in size and frequency. When projecting this long-term rate, the Company evaluated a three-year financial projection that excludes the impact of the following non-cash items: Stock-Based Expenses, Amortization of Purchased Intangibles, Amortization of Debt Discount, and Gains/Losses on Conversions of Debt. The projected rate also assumes no new acquisitions in the three-year period, and takes into account other factors including the Company's current tax structure, its existing tax

positions in various jurisdictions and key legislation in major jurisdictions where the Company operates. The non-GAAP tax rate for fiscal 2015 is 36.5%. The Company intends to re-evaluate this long-term rate on an annual basis or if any significant events that may materially affect this long-term rate occur. This long-term rate could be subject to change for a variety of reasons, for example, significant changes in the geographic earnings mix including acquisition activity, or fundamental tax law changes in major jurisdictions where the Company operates.

Table of Contents

We define non-GAAP gross profit as our total revenues less cost of revenues, as reported on our consolidated statement of operations, excluding the portions of stock-based expenses and amortization of purchased intangibles that are included in cost of revenues.

We define non-GAAP operating profit as our non-GAAP gross profit less operating expenses, as reported on our consolidated statement of operations, excluding the portions of stock-based expenses and amortization of purchased intangibles that are included in operating expenses.

Non-GAAP earnings per share

Management uses the non-GAAP earnings per share to provide an additional view of performance by excluding items that are not directly related to performance in any particular period in the earnings per share calculation.

We define non-GAAP earnings per share as our non-GAAP net income, which excludes the above components, which we believe are not reflective of our ongoing operational expenses, divided by basic or diluted shares outstanding.

Limitations on the use of non-GAAP financial measures

A limitation of our non-GAAP financial measures of non-GAAP gross profit, non-GAAP operating profit, non-GAAP net income and non-GAAP earnings per share is that they do not have uniform definitions. Our definitions will likely differ from the definitions used by other companies, including peer companies, and therefore comparability may be limited. Thus, our non-GAAP measures of non-GAAP gross profit, non-GAAP operating profit, non-GAAP net income and non-GAAP earnings per share should be considered in addition to, not as a substitute for, or in isolation from, measures prepared in accordance with GAAP. Additionally, in the case of stock-based expense, if we did not pay a portion of compensation in the form of stock-based expense, the cash salary expense included in costs of revenues and operating expenses would be higher which would affect our cash position.

We compensate for these limitations by reconciling non-GAAP gross profit, non-GAAP operating profit, non-GAAP net income and non-GAAP earnings per share to the most comparable GAAP financial measure. We encourage investors and others to review our financial information in its entirety, not to rely on any single financial measure and to view our non-GAAP financial measures in conjunction with the most comparable GAAP financial measures. Our reconciliation of the non-GAAP financial measures of gross profit, operating profit, net income and earnings per share to the most comparable GAAP measure, “gross profit,” “loss from operations,” “net income (loss)” and “net income (loss) per share” for the three and six months ended July 31, 2014 and 2013 are as follows (in thousands, except for share numbers):

	Three Months Ended July 31,		Six Months Ended July 31,	
	2014	2013	2014	2013
Non-GAAP gross profit				
GAAP gross profit	\$1,010,720	\$739,377	\$1,945,187	\$1,423,016
Plus:				
Amortization of purchased intangibles	21,271	22,550	49,943	43,855
Stock-based expenses	12,977	9,981	24,787	20,659
Non-GAAP gross profit	\$1,044,968	\$771,908	\$2,019,917	\$1,487,530
	Three Months Ended July 31,		Six Months Ended July 31,	
	2014	2013	2014	2013
Non-GAAP operating profit				
GAAP loss from operations	\$(33,434)	\$(39,857)	\$(88,775)	\$(84,397)
Plus:				
Amortization of purchased intangibles	35,919	27,026	79,556	50,791
Stock-based expenses	142,411	110,476	273,503	225,205
Non-GAAP operating profit	\$144,896	\$97,645	\$264,284	\$191,599

Table of Contents

	Three Months Ended July 31,		Six Months Ended July 31,	
	2014	2013	2014	2013
Non-GAAP net income				
GAAP net income (loss)	\$(61,088	) \$76,603	\$(157,999	) \$8,882
Plus:				
Amortization of purchased intangibles	35,919	27,026	79,556	50,791
Stock-based expenses	142,411	110,476	273,503	225,205
Amortization of debt discount, net	9,216	12,352	20,200	21,592
Loss on conversion of debt	361	0	8,890	0
Less:				
Income tax effects and adjustments of Non-GAAP items	(41,134	) (170,162	) (68,949	) (189,211
Non-GAAP net income	\$85,685	\$56,295	\$155,201	\$117,259
	Three Months Ended July 31,		Six Months Ended July 31,	
	2014	2013	2014	2013
Non-GAAP diluted earnings per share				
GAAP diluted income (loss) per share	\$(0.10	) \$0.12	\$(0.26	) \$0.01
Plus:				
Amortization of purchased intangibles	0.06	0.04	0.12	0.08
Stock-based expenses	0.22	0.18	0.42	0.36
Amortization of debt discount, net	0.01	0.02	0.03	0.03
Loss on conversion of debt	0.00	0.00	0.01	0.00
Less:				
Income tax effects and adjustments of Non-GAAP items	(0.06	) (0.27	) (0.08	) (0.29
Non-GAAP diluted earnings per share	\$0.13	\$0.09	\$0.24	\$0.19
Shares used in computing diluted net income per share	647,790	624,656	648,356	623,865

The effects of dilutive securities were not included in the GAAP calculation of diluted earnings/loss per share for the three and six months ended July 31, 2014 because we had a net loss for those periods and the effect would have been anti-dilutive. The effects of dilutive securities were included in the GAAP calculation of diluted earnings per share for the three and six months ended July 31, 2013 because we had net income for those periods. The following table reflects the effect of the dilutive securities on the basic share count used in the GAAP earnings/loss per share calculation to derive the share count used for the non-GAAP diluted earnings per share:

	Three Months Ended July 31,		Six Months Ended July 31,	
	2014	2013	2014	2013
Supplemental Diluted Sharecount Information (in thousands):				
Weighted-average shares outstanding for GAAP basic earnings per share	617,016	593,955	614,797	591,210
Effect of dilutive securities:				
Convertible senior notes	7,698	12,977	8,097	13,270
Warrants associated with the convertible senior note hedges	12,066	7,394	12,643	7,804
Employee stock awards	11,010	10,330	12,819	11,581
Adjusted weighted-average shares outstanding and assumed conversions for Non-GAAP diluted earnings per share	647,790	624,656	648,356	623,865





Table of Contents

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

## Foreign Currency Exchange Risk

Our results of operations and cash flows are subject to fluctuations due to changes in foreign currency exchange rates, particularly changes in the Euro, British Pound Sterling, Canadian Dollar and Japanese Yen. We seek to minimize the impact of certain foreign currency fluctuations by hedging certain balance sheet exposures with foreign currency forward contracts. Any gain or loss from settling these contracts is offset by the loss or gain derived from the underlying balance sheet exposures. In accordance with our policy, the hedging contracts we enter into have maturities of less than three months. Additionally, by policy, we do not enter into any hedging contracts for trading or speculative purposes.

## Interest Rate Sensitivity

We had cash, cash equivalents and marketable securities totaling \$1.7 billion at July 31, 2014. This amount was invested primarily in money market funds, time deposits, corporate notes and bonds, government securities and other debt securities with credit ratings of at least triple BBB or better. The cash, cash equivalents and short-term marketable securities are held for general corporate purposes including possible acquisitions of, or investments in, complementary businesses, services or technologies, working capital and capital expenditures. Our investments are made for capital preservation purposes. We do not enter into investments for trading or speculative purposes.

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

An immediate increase or decrease in interest rates of 100-basis points at July 31, 2014 could result in a \$14.1 million market value reduction or increase of the same amount. This estimate is based on a sensitivity model that measures market value changes when changes in interest rates occur. Fluctuations in the value of our investment securities caused by a change in interest rates (gains or losses on the carrying value) are recorded in other comprehensive income, and are realized only if we sell the underlying securities.

At January 31, 2014, we had cash, cash equivalents and marketable securities totaling \$1.3 billion. The fixed-income portfolio was also subject to interest rate risk. Changes in interest rates of 100-basis points would have resulted in market value changes of \$16.7 million.

## Market Risk and Market Interest Risk

In January 2010, we issued at par value \$575.0 million of 0.75% convertible senior notes due 2015 (the “0.75% Senior Notes”) and in March 2013, we issued at par value \$1.15 billion of 0.25% convertible senior notes (the “0.25% Senior Notes”) (collectively the “Notes”). Holders may convert the Notes prior to maturity upon the occurrence of certain circumstances. Upon conversion, we would pay the holder an amount of cash equal to the principal amounts of the Notes. Amounts in excess of the principal amounts of the Notes, if any, may be paid in cash or stock at our option. Concurrent with the issuance of the Notes, we entered into separate note hedging transactions and the sale of warrants. These separate transactions were completed to reduce the potential economic dilution from the conversion of the Notes.

The 0.75% Senior Notes and the 0.25% Senior Notes have fixed annual interest rates of 0.75% and 0.25%, respectively and therefore, we do not have economic interest rate exposure on the Notes. However, the value of the Notes are exposed to interest rate risk. Generally, the fair values of our fixed interest rate Notes will increase as interest rates fall and decrease as interest rates rise. In addition, the fair values of our Notes is affected by our stock price. The remaining carrying value of our 0.75% Senior Notes was \$265.1 million and the carrying value of our 0.25% Senior Notes was \$1.1 billion as of July 31, 2014, which represents the liability components of the \$271.3 million principal balance and \$1.15 billion principal balance, respectively. The total estimated fair values of our 0.75% Senior Notes and 0.25% Senior Notes at July 31, 2014 were \$699.9 million and \$1.3 billion, respectively. The

fair value was determined based on the closing trading price per \$100 of the 0.75% Senior Notes and 0.25% Senior Notes as of the last day of trading for the second quarter of fiscal 2015, which was \$258.00 and \$110.82, respectively.

Table of Contents

In July 2013, we entered into a \$300.0 million term loan (the “Term Loan”) which matures in July 2016 and bears interest at our option of either a base rate plus a spread of 0.50% to 1.00% or an adjusted LIBOR rate as defined in the Credit Agreement plus a spread of 1.50% to 2.00%. We entered into the Term Loan for purposes of partially funding the acquisition of ExactTarget. Interest is due and payable in arrears quarterly for the loan bearing interest as described above at the end of an interest period. The Term Loan is payable in quarterly installments equal to \$7.5 million with the remaining outstanding principal amount of the term loan being due and payable at maturity.

By entering into the Term Loan, we have assumed risks associated with variable interest rates based upon a variable base rate or LIBOR. The weighted average interest rate on the Term Loan was 1.8% for the three months ended July 31, 2014. Changes in the overall level of interest rates affect the interest expense that we recognize in our statements of operations.

We have an investment portfolio that includes strategic investments in public and privately-held companies, many of which are in the development stage. When our ownership interests are less than 20 percent and we do not have the ability to exert significant influence, we account for investments in non-marketable equity and debt securities of the privately-held companies using the cost method of accounting. Otherwise, we account for the investments using the equity method of accounting. As of July 31, 2014 and January 31, 2014 the carrying value of our investments in privately-held companies was \$109.6 million and \$77.0 million, respectively.

Table of Contents

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

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

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

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

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

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

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

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

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

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

We make a provision for a liability relating to legal matters when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impacts of negotiations, estimated settlements, legal rulings, advice of legal counsel and other information and events pertaining to a particular matter. In our opinion, resolution of all current matters is not expected to have a material adverse impact on our consolidated results of operations, cash flows or financial position. However, depending on the nature and timing of any such dispute, an unfavorable resolution of a matter could materially affect our future results of operations or cash flows, or both, of a particular quarter.

Table of Contents

ITEM 1A. RISK FACTORS

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

**Risks Related to Our Business and Industry**

Defects or disruptions in our service could diminish demand for our service and subject us to substantial liability.

Because our service is complex and incorporates a variety of hardware and proprietary and third-party software, our service may have errors or defects that could result in unanticipated downtime for our subscribers and harm to our reputation and our business. Internet-based services frequently contain undetected errors when first introduced or when new versions or enhancements are released. We have from time to time found defects in our service and new errors in our service may be detected in the future. In addition, our customers may use our service in unanticipated ways that may cause a disruption in service for other customers attempting to access their data. As we acquire companies, we may encounter difficulty in incorporating the acquired technologies into our service and maintaining the quality standards that are consistent with our brand and reputation. Since our customers use our service for important aspects of their business, any errors, defects, disruptions in service or other performance problems could hurt our reputation and may damage our customers' businesses. As a result, customers could elect to not renew, or delay or withhold payment to us, we could lose future sales or customers may make warranty or other 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.

Interruptions or delays in service from our third-party data center hosting facilities could impair the delivery of our service and harm our business.

We currently serve our customers from third-party data center hosting facilities located in the United States and other countries. Any damage to, or failure of, our systems generally could result in interruptions in our service. Interruptions in our service may reduce our revenue, cause us to issue credits or pay penalties, cause customers to terminate their subscriptions and adversely affect our attrition rates and our ability to attract new customers. Our business will also be harmed if our customers and potential customers believe our service is unreliable.

As part of our current disaster recovery arrangements, our production environment and all of our customers' data is currently replicated in near real-time in a facility located in the United States. Companies and products added through acquisition may be temporarily served through alternate facilities. We do not control the operation of any of these facilities, and they are vulnerable to damage or interruption from earthquakes, floods, fires, power loss, telecommunications failures and similar events. They may also be subject to break-ins, sabotage, intentional acts of vandalism and similar misconduct. Despite precautions taken at these facilities, the occurrence of a natural disaster or an act of terrorism, a decision to close the facilities without adequate notice or other unanticipated problems at these facilities could result in lengthy interruptions in our service. Even with the disaster recovery arrangements, our service could be interrupted.

As we continue to add data centers and add capacity in our existing data centers, we may move or transfer our data and our customers' data. Despite precautions taken during this process, any unsuccessful data transfers may impair the delivery of our service.

If our security measures are breached and unauthorized access is obtained to a customer's data or our data or our IT systems, our service may be perceived as not being secure, customers may curtail or stop using our service and we may incur significant legal and financial exposure and liabilities.

Our service involves the storage and transmission of customers' proprietary information, and security breaches could expose us to a risk of loss of this information, litigation and possible liability. These security measures may be breached as a result of third-party action, including intentional misconduct by computer hackers, employee error, malfeasance or otherwise and result in someone obtaining unauthorized access to our customers' data or our data, including our intellectual property and other confidential business information, or our IT systems. Additionally, third parties may attempt to fraudulently induce employees or customers into disclosing sensitive information such as user names, passwords or other information in order to gain access to our customers' data or our data or IT systems.

Because the techniques used to obtain unauthorized access, or to sabotage systems, change frequently and generally

are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. In addition, our customers may authorize third-party technology providers to access their customer data. Because we do not control our customers and third-party technology providers, or the processing of such data by third-party technology providers, we cannot ensure the integrity or security of such transmissions or processing. Malicious third-parties may also conduct attacks designed to temporarily deny customers access to our services. Any security breach could result in a loss of confidence in the security of our service, damage our reputation, negatively impact our future sales, disrupt our business and lead to legal liability.

60

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Table of Contents

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

As part of our business strategy, we periodically make investments in, or acquisitions of, complementary businesses, joint ventures, services and technologies and intellectual property rights, and we expect that we will continue to make such investments and acquisitions in the future. In July 2013, we acquired ExactTarget, our largest acquisition in the company's history. Acquisitions and investments involve numerous risks, including:

- the potential failure to achieve the expected benefits of the combination or acquisition;
- difficulties in and the cost of integrating operations, technologies, services and personnel;
- diversion of financial and managerial resources from existing operations;
- risk of entering new markets in which we have little or no experience or where competitors may have stronger market positions;
- potential write-offs of acquired assets or investments, and potential financial and credit risks associated with acquired customers;
- potential loss of key employees;
- inability to generate sufficient revenue to offset acquisition or investment costs;
- the inability to maintain relationships with customers and partners of the acquired business;
- the difficulty of transitioning the acquired technology onto our existing platforms and maintaining the security standards consistent with our other services for such technology;
- potential unknown liabilities associated with the acquired businesses;
- unanticipated expenses related to acquired technology and its integration into existing technology;
- negative impact to our results of operations because of the depreciation and amortization of amounts related to acquired intangible assets, fixed assets and deferred compensation, and the loss of acquired deferred revenue and unbilled deferred revenue;
- delays in customer purchases due to uncertainty related to any acquisition;
- the need to implement controls, procedures and policies at the acquired company;
- challenges caused by distance, language and cultural differences;
- in the case of foreign acquisitions, the challenges associated with integrating operations across different cultures and languages and any currency and regulatory risks associated with specific countries; and
- the tax effects of any such acquisitions.

In addition, if we finance acquisitions by issuing equity or convertible or other debt securities or loans, our existing stockholders may be diluted, or we could face constraints related to the terms of and repayment obligation related to the incurrence of indebtedness which could affect the market price of our common stock. Further, if we fail to properly evaluate and execute acquisitions or investments, our business and prospects may be seriously harmed and the value of your investment may decline.

Privacy concerns and laws, evolving regulation of cloud computing, cross-border data transfer restrictions and other domestic or foreign regulations may limit the use and adoption of our solutions and adversely affect our business. Regulation related to the provision of services on the Internet is increasing, as federal, state and foreign governments continue to adopt new laws and regulations addressing data privacy and the collection, processing, storage and use of personal information. In some cases foreign data privacy laws and regulations, such as the European Union's Data Protection Directive, and the country-specific regulations that implement that directive, also govern the processing of personal information. Further, laws are increasingly aimed at the use of personal information for marketing purposes, such as the European Union's e-Privacy Directive, and the country-specific regulations that implement that directive. Such laws and regulations are subject to differing interpretations and may be inconsistent among jurisdictions. These and other requirements could reduce demand for our solutions or restrict our ability to store and process data or, in some cases, impact our ability to offer our services and solutions in certain locations.

In addition to government activity, privacy advocacy and other industry groups have established or may establish new self-regulatory standards that may place additional burdens on us. Our customers expect us to meet voluntary



certification or other standards established by third parties, such as TRUSTe. If we are unable to maintain these certifications or meet these standards, it could adversely affect our ability to provide our solutions to certain customers and could harm our business.

## Table of Contents

The costs of compliance with and other burdens imposed by laws, regulations and standards may limit the use and adoption of our service and reduce overall demand for it, or lead to significant fines, penalties or liabilities for any noncompliance.

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

Industry-specific regulation is evolving and unfavorable industry-specific laws, regulations or interpretive positions could harm our business.

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

In some cases, industry-specific laws, regulations or interpretive positions may also apply directly to us as a service provider. Any failure or perceived failure by us to comply with such requirements could have an adverse impact on our business.

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

Due to the pace of change and innovation in enterprise cloud computing services and the unpredictability of future general economic and financial market conditions, we may not be able to accurately forecast our rate of growth. We plan our expense levels and investment on estimates of future revenue and future anticipated rate of growth. We may not be able to adjust our spending appropriately if the addition of new subscriptions or the renewals of existing subscriptions falls short of our expectations. A portion of our expenses may also be a fixed cost in nature for some minimum amount of time, such as with a data center contract or office lease, so it may not be possible to reduce costs in a timely manner or without the payment of fees to exit certain obligations early.

As a result, we expect that our revenues, operating results and cash flows may fluctuate significantly on a quarterly basis. Our recent revenue growth rates may not be sustainable and may decline in the future. We believe that period-to-period comparisons of our revenues, operating results and cash flows may not be meaningful and should not be relied upon as an indication of future performance.

We rely on third-party computer hardware and software which could cause errors or failures of our service and may be difficult to replace.

We rely on computer hardware purchased or leased and software licensed from third parties in order to offer our service, including database software and hardware from a variety of vendors. Any errors or defects in third-party hardware or software could result in errors or a failure of our service which could harm our business. This hardware and software may not continue to be available at reasonable prices or on commercially reasonable terms, or at all. Any loss of the right to use any of this hardware or software could significantly increase our expenses and otherwise result in delays in the provisioning of our service until equivalent technology is either developed by us, or, if available, is identified, obtained through purchase or license and integrated into our service.

Our quarterly results can fluctuate and our stock price and the value of your investment could decline substantially. Our quarterly results are likely to fluctuate. For example, our fiscal fourth quarter has historically been our strongest quarter for new business and renewals. The year-over-year compounding effect of this seasonality in billing patterns and overall new business and renewal activity causes the value of invoices that we generate in the fourth quarter to continually increase in proportion to our billings in the other three quarters of our fiscal year.

Table of Contents

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

- our ability to retain and increase sales to existing customers, attract new customers and satisfy our customers' requirements;
- the attrition rates for our service;
- the amount and timing of operating costs and capital expenditures related to the operations and expansion of our business;
- changes in deferred revenue and unbilled deferred revenue balances, which are not reflected in the balance sheet, due to seasonality, the compounding effects of renewals, invoice duration, invoice timing and new business linearity between quarters and within a quarter;
- the number of new employees;
- changes in our pricing policies and terms of contracts, whether initiated by us or as a result of competition;
- the cost, timing and management effort for the introduction of new features to our service;
  - the costs associated with acquiring new businesses and technologies and the follow-on costs of integration and consolidating the results of acquired businesses;
- the rate of expansion and productivity of our sales force;
- the length of the sales cycle for our service;
- new product and service introductions by our competitors;
- our success in selling our service to large enterprises;
- variations in the revenue mix of editions of our service;
  - technical difficulties or interruptions in our service;
- expenses related to our real estate, our office leases and our data center capacity and expansion;
- changes in foreign currency exchange rates;
- changes in interest rates and our mix of investments, which would impact our return on our investments in cash and marketable securities;
- conditions, particularly sudden changes, in the financial markets have and may continue to impact the value of and access to our investment portfolio;
- changes in the effective tax rates due to changes in the mix of earnings and losses in countries with differing statutory tax rates, certain non-deductible expenses, changes in the valuation of deferred tax assets and liabilities and our ability to utilize them, changes in federal, state or international tax laws including fundamental changes to tax laws applicable to corporate multinationals that may be considered by the United States and many countries in the European Union, changes in accounting principles, changes in judgment from the evaluation of new information that results in a recognition, derecognition or change in measurement of a tax position taken in a prior period, results of tax examinations by the Internal Revenue Service, state and foreign taxing authorities, as well as changes in excess tax benefits related to exercises and vesting of stock-based compensation;
- changes to non-income taxes due to changes in federal, state or international tax laws; changes in taxing jurisdictions' administrative interpretations, decisions, policies, and positions; results of tax examinations, settlements or judicial decisions; changes in accounting principles; changes to the business operations, including acquisitions, as well as the evaluation of new information that results in a change to a tax position taken in a prior period;
- our ability to realize benefits from strategic partnerships;
- expenses related to significant, unusual or discrete events which are recorded in the period in which the events occur;
- general economic conditions that may adversely affect either our customers' ability or willingness to purchase additional subscriptions or upgrade their service, or delay a prospective customers' purchasing decision, or reduce the value of new subscription contracts, or affect attrition rates;
- timing of additional investments in our enterprise cloud computing application and platform services and in our consulting service;
- regulatory compliance costs;
- the timing of customer payments and payment defaults by customers;



Table of Contents

- extraordinary expenses such as litigation or other dispute-related settlement payments;
- the impact of new accounting pronouncements;
- equity issuances, including as consideration in acquisitions or due to the conversion of our outstanding convertible notes at the election of the note holders;
- the timing of stock awards to employees and the related adverse financial statement impact of having to expense those stock awards on a straight-line basis over their vesting schedules;
- the timing of commission, bonus, and other compensation payments to employees; and
- the timing of payroll and other withholding tax expenses which is triggered by the payment of bonuses and when employees exercise their vested stock awards.

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

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

Our efforts to expand our service beyond the CRM market and to develop our existing service in order to keep pace with technological developments may not succeed and may reduce our revenue growth rate and/or harm our business. We derive substantially all of our revenue from subscriptions to our CRM enterprise cloud computing application service, and we expect this will continue for the foreseeable future. The markets for our ExactTarget Marketing Cloud and Salesforce1 Platform remain relatively new and it is uncertain whether our efforts will ever result in significant revenue for us. Further, the introduction of new services beyond the CRM market may not be successful, and early stage interest and adoption of such new services may not result in long term success or significant revenue for us. Our efforts to expand our service beyond the CRM market may not succeed and may reduce our revenue growth rate. Additionally, if we are unable to develop enhancements to and new features for our existing service or new services that keep pace with rapid technological developments, our business will be harmed. The success of enhancements, new features and services depends on several factors, including the timely completion, introduction and market acceptance of the feature or edition. Failure in this regard may significantly impair our revenue growth. In addition, because our service is designed to operate on a variety of network hardware and software platforms using a standard browser, we will need to continuously modify and enhance our service to keep pace with changes in Internet-related hardware, software, communication, browser and database technologies. We may not be successful in either developing these modifications and enhancements or in bringing them to market timely. Furthermore, uncertainties about the timing and nature of new network platforms or technologies, or modifications to existing platforms or technologies, could increase our research and development or service delivery expenses. Any failure of our service to operate effectively with future network platforms and technologies could reduce the demand for our service, result in customer dissatisfaction and harm our business.

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

We generally recognize revenue from customers ratably over the terms of their subscription agreements, which are typically 12 to 36 months. As a result, most of the revenue we report in each quarter is the result of subscription agreements entered into during previous quarters. Consequently, a decline in new or renewed subscriptions in any one quarter may not be reflected in our revenue results for that quarter. Any such decline, however, will negatively affect our revenue in future quarters. Accordingly, the effect of significant downturns in sales and market acceptance of our service, and potential changes in our attrition rate may not be fully reflected in our results of operations until future periods. Our subscription model also makes it difficult for us to rapidly increase our revenue through additional sales in any period, as revenue from new customers must be recognized over the applicable subscription term.



Table of Contents

We cannot accurately predict subscription renewals or upgrade rates and the impact these rates may have on our future revenue and operating results.

Our customers have no obligation to renew their subscriptions for our service after the expiration of their initial subscription period, which is typically 12 to 36 months, and in the normal course of business, some customers have elected not to renew. In addition, our customers may renew for fewer subscriptions, renew for shorter contract lengths, or renew for lower cost editions of our service. We cannot accurately predict attrition rates given our varied customer base of enterprise and small and medium size business customers and the number of multi-year subscription contracts. Our attrition rates may increase or fluctuate as a result of a number of factors, including customer dissatisfaction with our service, customers' spending levels, decreases in the number of users at our customers, pricing changes and deteriorating general economic conditions. If our customers do not renew their subscriptions for our service or reduce the number of paying subscriptions at the time of renewal, our revenue will decline and our business will suffer.

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

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

The market for enterprise applications and platform services is highly competitive, rapidly evolving and fragmented, and subject to changing technology, shifting customer needs and frequent introductions of new products and services.

We compete primarily with vendors of packaged CRM software and companies offering on-demand CRM applications. We also compete with internally developed applications and face competition from enterprise software vendors and online service providers who may develop toolsets and products that allow customers to build new applications that run on the customers' current infrastructure or as hosted services. Our current competitors include:

- enterprise software application vendors;

- cloud computing application service providers;

- software companies that provide their product or service free of charge, and only charge a premium for advanced features and functionality;

- traditional platform development environment companies; and

- cloud computing development platform companies.

Many of our current and potential competitors enjoy substantial competitive advantages, such as greater name recognition, longer operating histories and larger marketing budgets, as well as substantially greater financial, technical and other resources. In addition, many of our current and potential competitors have established marketing relationships and access to larger customer bases, and have major distribution agreements with consultants, system integrators and resellers.

As a result, our competitors may be able to respond more quickly and effectively than we can to new or changing opportunities, technologies, standards or customer requirements. Furthermore, because of these advantages, even if our service is more effective than the products that our competitors offer, potential customers might accept competitive products and services in lieu of purchasing our service. For all of these reasons, we may not be able to compete successfully against our current and future competitors.

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

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



warranties for the third-party applications, which may expose us to potential claims, liabilities and obligations for applications we did not develop or sell.

65

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Table of Contents

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

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

We regularly upgrade and/or replace our various software systems. If the implementations of these new applications are delayed, or if we encounter unforeseen problems with our new systems or in migrating away from our existing applications and systems, our operations and our ability to manage our business could be negatively impacted.

Our success will depend in part upon the ability of our senior management to manage our projected growth effectively. To do so, we must continue to increase the productivity of our existing employees and to hire, train and manage new employees as needed. To manage the expected domestic and international growth of our operations and personnel, we will need to continue to improve our operational, financial and management controls, our reporting systems and procedures, and our utilization of real estate. The additional investments we are making will increase our cost base, which will make it more difficult for us to offset any future revenue shortfalls by reducing expenses in the short term. If we fail to successfully scale our operations and increase productivity, we will be unable to execute our business plan.

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

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

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

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

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

We periodically change and make adjustments to our sales organization in response to market opportunities, competitive threats, management changes, product introductions or enhancements, acquisitions, sales performance, increases in sales headcount, cost levels and other internal and external considerations. In the past, these changes sometimes resulted in a temporary lack of focus and reduced productivity; these effects could recur in connection with

any future sales changes we might undertake and our rate of revenue growth could be negatively affected. In addition, any significant change to the way we structure our compensation of our sales organization may be disruptive and may affect our revenue growth.

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

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

Table of Contents

• localization of our service, including translation into foreign languages and associated expenses;

• laws and business practices favoring local competitors;

• compliance with multiple, conflicting and changing governmental laws and regulations, including employment, tax, privacy, anti-corruption, import/export, antitrust, data protection and industry-specific laws and regulations, including rules related to compliance by our third-party resellers;

• pressure on the creditworthiness of sovereign nations, particularly in Europe, where we have customers and a balance of our cash, cash equivalents, and marketable securities. Liquidity issues or political actions by sovereign nations could result in decreased values of these balances;

• regional data privacy laws and other regulatory requirements that apply to outsourced service providers and to the transmission of our customers' data across international borders;

• treatment of revenue from international sources and changes to tax codes, including being subject to foreign tax laws and being liable for paying withholding income or other taxes in foreign jurisdictions;

• foreign currency fluctuations and controls;

• different pricing environments;

• difficulties in staffing and managing foreign operations;

• different or lesser protection of our intellectual property;

• longer accounts receivable payment cycles and other collection difficulties;

• natural disasters, acts of war, terrorism, pandemics or security breaches; and

• regional economic and political conditions.

Any of these factors could negatively impact our business and results of operations.

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

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

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

The software and Internet industries are characterized by the existence of a large number of patents, trademarks and copyrights and by frequent litigation based on allegations of infringement or other violations of intellectual property rights. We have received in the past and may receive in the future communications from third parties, including practicing entities and non-practicing entities, claiming that we have infringed their intellectual property rights. For example, we received a notice from a large non-practicing entity alleging that we infringed upon certain of its patents. While no litigation was ever filed, in May 2013 we entered into a multi-year license agreement with the non-practicing entity that covered past period and future non-exclusive rights to its intellectual property.

In addition, we have been, and may in the future be, sued by third parties for alleged infringement of their claimed proprietary rights. Our technologies may be subject to injunction if they are found to infringe the rights of a third party or we may be required to pay damages, or both. Many of our subscription agreements require us to indemnify our customers for third-party intellectual property infringement claims, which would increase the cost to us of an adverse ruling on such a claim.

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

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

67

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Table of Contents

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

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

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

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

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

We believe that the brand identities we have developed have significantly contributed to the success of our business. Maintaining and enhancing the salesforce.com brand and our other brands are critical to expanding our base of customers, partners and employees. Our brands will depend largely on our ability to remain a technology leader and continue to provide high-quality innovative products, services, and features. In order to maintain and enhance our brands, we may be required to make substantial investments that may later prove to be unsuccessful. If we fail to maintain and enhance our brands, or if we incur excessive expenses in our efforts to do so, our business, operating results and financial condition may be materially and adversely affected.

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

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

In the technology industry, there is substantial and continuous competition for engineers with high levels of experience in designing, developing and managing software and Internet-related services, as well as competition for sales executives and operations personnel. We may not be successful in attracting and retaining qualified personnel. We have from time to time experienced, and we expect to continue to experience, difficulty in hiring and retaining highly skilled employees with appropriate qualifications. If we fail to attract new personnel or fail to retain and

motivate our current personnel, our business and future growth prospects could be severely harmed.

68

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Table of Contents

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

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

We expect to incur net GAAP losses in the future.

We have incurred net losses in each fiscal quarter except one since July 31, 2011. In addition, we expect our costs to increase as a result of decisions made for our long-term benefit, such as equity awards and business combinations. If our revenue does not grow to offset these expected increased costs, we will not be able to return to profitability and we may continue to incur net losses, on a U.S. GAAP basis, in the future.

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

We have a higher level of debt compared to historical periods, including our outstanding \$271.3 million of 0.75% Senior Notes due January 15, 2015, \$1.15 billion in aggregate principal amount of 0.25% Senior Notes due April 1, 2018, \$270.0 million term loan maturing in July 2016 with Bank of America, N.A. and certain other lenders and capital lease arrangements in excess of \$500.0 million. Additionally, we have contractually committed to over \$2.0 billion in operating lease arrangements, which are not reflected on our condensed consolidated balance sheet. In addition, we have a financing obligation in the amount of \$335.8 million for a leased facility of which we are deemed the owner for accounting purposes. Our maintenance of this indebtedness could have important consequences because:

- it may impair our ability to obtain additional financing in the future for working capital, capital expenditures, acquisitions, general corporate or other purposes;
- an increased portion of our cash flows from operations may have to be dedicated towards repaying the principal beginning in 2015 or earlier if necessary;
- it may make us more vulnerable to downturns in our business, our industry or the economy in general;
- and

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

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

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



We may not realize any benefits in connection with the unsold portions of our undeveloped land in San Francisco, and our financial performance may be negatively impacted.

In November 2010, we purchased approximately 14 net acres of undeveloped real estate in San Francisco, California, including entitlements and improvements associated with the land. We may not realize any benefits with respect to the purchase of such real estate. While we have already sold a portion of this land, and the remaining portions are under contracts for sale, it is possible that the sales of the remaining portions will not close or that the aggregate sales proceeds for the unsold portions may ultimately be less than the recorded value of the land on our consolidated balance sheet, and our financial results may be negatively impacted.

Table of Contents

Weakened global economic conditions may adversely affect our industry, business and results of operations. Our overall performance depends in part on worldwide economic conditions. The United States and other key international economies have experienced in the past a downturn in which economic activity was impacted by falling demand for a variety of goods and services, restricted credit, poor liquidity, reduced corporate profitability, volatility in credit, equity and foreign exchange markets, bankruptcies and overall uncertainty with respect to the economy. The European Union continues to face great economic uncertainty which could impact the overall world economy or various other regional economies. These conditions affect the rate of information technology spending and could adversely affect our customers' ability or willingness to purchase our enterprise cloud computing services, delay prospective customers' purchasing decisions, reduce the value or duration of their subscription contracts, or affect attrition rates, all of which could adversely affect our operating results.

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

Natural disasters or other catastrophic events may cause damage or disruption to our operations, international commerce and the global economy, and thus could have a strong negative effect on us. Our business operations are subject to interruption by natural disasters, fire, power shortages, pandemics and other events beyond our control. Although we maintain crisis management and disaster response plans, such events could make it difficult or impossible for us to deliver our services to our customers, and could decrease demand for our services. The majority of our research and development activities, corporate headquarters, information technology systems, and other critical business operations, are located near major seismic faults in the San Francisco Bay Area. Because we do not carry earthquake insurance for direct quake-related losses, and significant recovery time could be required to resume operations, our financial condition and operating results could be materially adversely affected in the event of a major earthquake or catastrophic event.

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

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

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

Factors affecting the market price of our notes and underlying common stock include:

- variations in our operating results, earnings per share, cash flows from operating activities, deferred revenue and other financial metrics and non-financial metrics, and how those results compare to analyst expectations;
- forward-looking guidance to industry and financial analysts related to future revenue and earnings per share;
- changes in the estimates of our operating results or changes in recommendations by securities analysts that elect to follow our common stock;
- announcements of technological innovations, new services or service enhancements, strategic alliances or significant agreements by us or by our competitors;
- announcements by us or by our competitors of mergers or other strategic acquisitions, or rumors of such transactions involving us or our competitors;
- announcements of customer additions and customer cancellations or delays in customer purchases;
- recruitment or departure of key personnel;
- disruptions in our service due to computer hardware, software, network or data center problems;
- the economy as a whole, market conditions in our industry and the industries of our customers;
- trading activity by a limited number of stockholders who together beneficially own a majority of our outstanding common stock;
- the issuance of shares of common stock by us, whether in connection with an acquisition, a capital raising transaction or upon conversion of some or all of our outstanding convertible senior notes;
- issuance of debt or other convertible securities; and
- any other factors discussed herein.

In addition, if the market for technology stocks or the stock market in general experiences uneven investor confidence, the market price of our notes and underlying common stock could decline for reasons unrelated to our business, operating results or financial condition. The market price of our notes and underlying common stock might also decline in reaction to events that affect other companies within, or outside, our industry even if these events do not

directly affect us. Some companies that have experienced volatility in the trading price of their stock have been the subject of securities class action litigation. If we are the subject of such litigation, it could result in substantial costs and a diversion of management's attention and resources.

70

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Table of Contents

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

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

We may not have the ability to raise the funds necessary to pay the amount of cash due upon conversion of the notes or the fundamental change purchase price due when a holder submits its notes for purchase upon the occurrence of a fundamental change.

Upon the occurrence of a fundamental change, holders may require us to purchase, for cash, all or a portion of their notes. In addition, if a holder converts its notes, we will generally pay such holder an amount of cash before delivering to such holder any shares of our common stock.

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

The fundamental change provisions may delay or prevent an otherwise beneficial takeover attempt of us.

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

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

We entered into privately negotiated convertible note hedge transactions with the hedge counterparties concurrently with the pricing of the notes. We also entered into privately negotiated warrant transactions with the hedge counterparties. Taken together, the convertible note hedge transactions and the warrant transactions are expected, but not guaranteed, to reduce the potential dilution with respect to our common stock upon conversion of the notes. If, however, the price of our common stock, as measured under the terms of the warrant transactions, exceeds the exercise price of the warrant transactions, the warrant transactions will have a dilutive effect on our earnings per share to the extent that the price of our common stock as measured under the warrant transactions exceeds the strike price of the warrant transactions.

The hedge counterparties and their respective affiliates periodically modify their hedge positions from time to time following the pricing of the notes (and are particularly likely to do so during any observation period relating to a conversion of the notes) by entering into or unwinding various over-the-counter derivative transactions with respect to our common stock, and/or by purchasing or selling shares of our common stock or the notes in privately negotiated transactions and/or open market transactions. The effect, if any, of these transactions and activities on the market price

of our common stock or the trading price of the notes will depend in part on market conditions and cannot be ascertained at this time. Any of these activities, however, could adversely affect the market price of our common stock and the trading price of the notes.

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

Table of Contents

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

The hedge counterparties are financial institutions or affiliates of financial institutions, and we will be subject to the risk that these hedge counterparties may default under the convertible note hedge transactions. Our exposure to the credit risk of the hedge counterparties will not be secured by any collateral. If one or more of the hedge counterparties to one or more of our convertible note hedge transactions becomes subject to insolvency proceedings, we will become an unsecured creditor in those proceedings with a claim equal to our exposure at the time under those transactions.

Our exposure will depend on many factors but, generally, the increase in our exposure will be correlated to the increase in our stock price and in the volatility of our stock. In addition, upon a default by one of the hedge counterparties, we may suffer adverse tax consequences and dilution with respect to our common stock. We can provide no assurances as to the financial stability or viability of any of the hedge counterparties.

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

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

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

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

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



Table of Contents

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

As previously disclosed on a Form 8-K filed on July 11, 2014, on July 10, 2014 the Company entered into an Agreement and Plan of Reorganization to acquire RelateIQ, Inc. (“RelateIQ”), a relationship intelligence platform. Upon closing the transaction on August 1, 2014, the Company issued 7,189,294 shares of Company common stock in exchange for the outstanding shares of RelateIQ capital stock. This issuance of shares was made in reliance on one or more of the following exemptions or exclusions from the registration requirements of the Securities Act of 1933, as amended (the “Securities Act”): Section 4(a)(2) of the Securities Act, Regulation D promulgated under the Securities Act, and Regulation S promulgated under the Securities Act.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5. OTHER INFORMATION**

Not applicable.



Table of Contents

## ITEM 6. EXHIBITS

## Exhibits

The Exhibits listed below are filed as part of this Form 10-Q.

## Index to Exhibits

Exhibit No.	Exhibit Description	Provided Herewith	Incorporated by Reference			Filing Date
			Form	SEC File No.	Exhibit	
3.1	Amended and Restated Certificate of Incorporation of salesforce.com, inc.		8-K	001-32224	3.1	06/11/2013
3.2	Amended and Restated Bylaws of salesforce.com, inc.		8-K	001-32224	3.2	06/11/2013
10.1*	2014 Inducement Equity Incentive Plan and Related Forms of Equity Award Agreements		8-K	001-32224	10.1	07/11/2014
10.2*	Employment Offer Letter, dated June 11, 2014, between salesforce.com, inc. and Mark Hawkins		8-K	001-32224	10.1	06/30/2014
10.3	Amendment No. 1 to Credit Agreement, dated as of June 30, 2014, by and among salesforce.com, inc., the guarantors from time to time party thereto and Bank of America, N.A., as Administrative Agent	X				
10.4*	Kokua Bonus Plan, as amended and restated May 30, 2014, effective February 1, 2014	X				
31.1	Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a) or 15(d)-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X				
31.2	Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a) or 15(d)-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X				
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X				

Table of Contents

Exhibit No.	Exhibit Description	Provided Herewith	Incorporated by Reference Form	SEC File No.	Exhibit	Filing Date
101.INS†	XBRL Instance Document					
101.SCH†	XBRL Taxonomy Extension Schema Document					
101.CAL†	XBRL Taxonomy Extension Calculation Linkbase Document					
101.DEF†	XBRL Extension Definition					
101.LAB†	XBRL Taxonomy Extension Label Linkbase Document					
101.PRE†	XBRL Taxonomy Extension Presentation Linkbase Document					

\* Indicates a management contract or compensatory plan or arrangement

† The financial information contained in these XBRL documents is unaudited and these are not the official publicly filed financial statements of salesforce.com, inc. The purpose of submitting these XBRL documents is to test the related format and technology, and, as a result, investors should continue to rely on the official filed version of the furnished documents and not rely on this information in making investment decisions. In accordance with Rule 402 of Regulation S-T, the information in these exhibits shall not be deemed to be “filed” for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act, or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.

Table of Contents

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.

August 26, 2014

salesforce.com, inc.  
/s/ MARK HAWKINS  
Mark Hawkins  
Chief Financial Officer

August 26, 2014

salesforce.com, inc.  
/s/ JOE ALLANSON  
Joe Allanson  
Senior Vice President, Chief Accountant and  
Controller  
(Principal Accounting Officer)