

SALESFORCE COM INC
Form 10-Q
August 25, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended July 31, 2015

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, 2015, there were approximately 660.0 million shares of the Registrant's Common Stock outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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Condensed Consolidated Balance Sheets

(in thousands)

	July 31, 2015 (unaudited)	January 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	\$ 1,089,351	\$ 908,117
Short-term marketable securities	81,118	87,312
Accounts receivable, net	1,067,799	1,905,506
Deferred commissions	211,314	225,386
Prepaid expenses and other current assets	330,291	280,554
Land and building improvements held for sale	136,914	143,197
Total current assets	2,916,787	3,550,072
Marketable securities, noncurrent	896,494	894,855
Property and equipment, net	1,725,184	1,125,866
Deferred commissions, noncurrent	143,871	162,796
Capitalized software, net	414,035	433,398
Goodwill	3,804,288	3,782,660
Strategic investments	477,886	175,774
Other assets, net	415,432	452,546
Restricted cash	0	115,015
Total assets	\$ 10,793,977	\$ 10,692,982
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable, accrued expenses and other liabilities	\$ 1,098,054	\$ 1,103,335
Deferred revenue	3,014,940	3,286,768
Total current liabilities	4,112,994	4,390,103
Convertible 0.25% senior notes, net	1,082,799	1,070,692
Loan assumed on 50 Fremont	198,813	0
Revolving credit facility	0	300,000
Deferred revenue, noncurrent	20,051	34,681
Other noncurrent liabilities	843,517	922,323
Total liabilities	6,258,174	6,717,799
Stockholders' equity:		
Common stock	660	651
Additional paid-in capital	5,165,892	4,604,485
Accumulated other comprehensive loss	(28,144	) (24,108
Accumulated deficit	(602,605	) (605,845
Total stockholders' equity	4,535,803	3,975,183
Total liabilities and stockholders' equity	\$ 10,793,977	\$ 10,692,982

See accompanying Notes.

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Condensed Consolidated Statements of Operations

(in thousands, except per share data)

(unaudited)

	Three Months Ended July 31,		Six Months Ended July 31,	
	2015	2014	2015	2014
Revenues:				
Subscription and support	\$1,521,319	\$1,232,587	\$2,926,606	\$2,379,893
Professional services and other	113,365	85,964	219,245	165,430
Total revenues	1,634,684	1,318,551	3,145,851	2,545,323
Cost of revenues (1)(2):				
Subscription and support	292,737	218,918	566,978	427,865
Professional services and other	112,647	88,913	220,208	172,271
Total cost of revenues	405,384	307,831	787,186	600,136
Gross profit	1,229,300	1,010,720	2,358,665	1,945,187
Operating expenses (1)(2):				
Research and development	234,100	203,109	456,228	391,467
Marketing and sales	793,691	671,958	1,530,629	1,311,313
General and administrative	181,685	169,087	357,496	331,182
Operating lease termination resulting from purchase of 50 Fremont, net	0	0	(36,617)	) 0
Total operating expenses	1,209,476	1,044,154	2,307,736	2,033,962
Income (loss) from operations	19,824	(33,434)	) 50,929	(88,775)
Investment income	3,283	2,655	7,844	4,433
Interest expense	(18,096)	) (18,314)	) (34,771)	) (38,673)
Other income (expense) (1)(3)	1,947	(3,876)	) 1,029	(14,723)
Income (loss) before provisions for income taxes	6,958	(52,969)	) 25,031	(137,738)
Provisions for income taxes	(7,810)	) (8,119)	) (21,791)	) (20,261)
Net income (loss)	\$(852)	) \$(61,088)	) \$3,240	\$(157,999)
Basic net income (loss) per share	\$0.00	\$(0.10)	) \$0.00	\$(0.26)
Diluted net income (loss) per share	\$0.00	\$(0.10)	) \$0.00	\$(0.26)
Shares used in computing basic net income (loss) per share	659,366	617,016	656,636	614,797
Shares used in computing diluted net income (loss) per share	659,366	617,016	672,231	614,797

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

	Three Months Ended July 31,		Six Months Ended July 31,	
	2015	2014	2015	2014
Cost of revenues	\$20,839	\$21,271	\$40,529	\$49,943
Marketing and sales	19,002	14,648	39,029	29,613
Other non-operating expense	1,301	0	2,116	0

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

	Three Months Ended July 31,		Six Months Ended July 31,	
	2015	2014	2015	2014
Cost of revenues	\$16,340	\$12,977	\$31,721	\$24,787
Research and development	33,732	33,112	64,974	60,396
Marketing and sales	71,724	70,485	142,258	137,618

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General and administrative	25,983	25,837	51,386	50,702
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(3) Amount includes approximately \$8.9 million loss on conversions of our convertible 0.75% senior notes due January 2015 recognized during the six months ended July 31, 2014.
See accompanying Notes.

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Condensed Consolidated Statements of Comprehensive Loss

(in thousands)

(unaudited)

	Three Months Ended July 31,		Six Months Ended July 31,		
	2015	2014	2015	2014	
Net income (loss)	\$ (852	) \$ (61,088	) \$ 3,240	\$ (157,999)
Other comprehensive loss, before tax and net of reclassification adjustments:					
Foreign currency translation and other losses	(5,391	) (5,299	) (7,246	) (2,184)
Unrealized gains (loss) on investments	5,599	1,164	3,210	(4,333)
Other comprehensive gain (loss), before tax	208	(4,135	) (4,036	) (6,517)
Tax effect	0	0	0	0	
Other comprehensive gain (loss), net of tax	208	(4,135) (4,036) (6,517)
Comprehensive loss	\$ (644) \$ (65,223) \$ (796) \$ (164,516)

See accompanying Notes.

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Condensed Consolidated Statements of Cash Flows

(in thousands)

(unaudited)

	Three Months Ended July 31,		Six Months Ended July 31,	
	2015	2014	2015	2014
Operating activities:				
Net income (loss)	\$(852	) \$(61,088	) \$3,240	\$(157,999
Adjustments to reconcile net income (loss) to net cash provided by operating activities:				
Depreciation and amortization	131,675	107,596	259,602	218,404
Amortization of debt discount and transaction costs	7,291	9,949	13,152	21,740
50 Fremont lease termination, net	0	0	(36,617	) 0
Loss on conversions of convertible senior notes	0	361	0	8,890
Amortization of deferred commissions	76,679	61,300	153,834	121,155
Expenses related to employee stock plans	147,779	142,411	290,339	273,503
Excess tax benefits from employee stock plans	133	6,815	(4,091	) (2,226
Changes in assets and liabilities, net of business combinations:				
Accounts receivable, net	(141,418	) (150,168	) 837,752	526,514
Deferred commissions	(70,745	) (65,846	) (120,837	) (106,742
Prepaid expenses and other current assets and other assets	(18,072	) 23,636	(29,346	) 27,913
Accounts payable, accrued expenses and other liabilities	193,771	142,638	(45,301	) (42,961
Deferred revenue	(21,830	) 28,289	(286,459	) (169,211
Net cash provided by operating activities	304,411	245,893	1,035,268	718,980
Investing activities:				
Business combinations, net of cash acquired	(18,451	) 0	(30,921	) 0
Purchase of 50 Fremont land and building	0	0	(425,376	) 0
Deposit for purchase of 50 Fremont land and building	0	0	115,015	0
Non-refundable amounts received for sale of land available for sale	3,432	1,000	6,284	31,000
Strategic investments	(150,434	) (18,807	) (294,896	) (35,053
Purchases of marketable securities	(136,196	) (284,928	) (343,421	) (535,464
Sales of marketable securities	130,922	71,073	323,106	150,385
Maturities of marketable securities	1,833	16,762	16,279	23,960
Capital expenditures	(64,883	) (71,576	) (135,970	) (131,674
Net cash used in investing activities	(233,777	) (286,476	) (769,900	) (496,846
Financing activities:				
Proceeds from employee stock plans	114,799	61,429	269,814	135,224
Excess tax benefits from employee stock plans	(133	) (6,815	) 4,091	2,226
Payments on convertible senior notes	0	(13,692	) 0	(297,584
Principal payments on capital lease obligations	(41,074	) (40,341	) (57,899	) (50,935
Payments on revolving credit facility and term loan	0	(7,500	) (300,000	) (15,000
Net cash provided by (used in) financing activities	73,592	(6,919) (83,994) (226,069
Effect of exchange rate changes	3,169	(5,664) (140) (2,975

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Net increase (decrease) in cash and cash equivalents	147,395	(53,166)	181,234	(6,910)
Cash and cash equivalents, beginning of period	941,956	827,891		908,117	781,635	
Cash and cash equivalents, end of period	\$1,089,351	\$774,725		\$1,089,351	\$774,725	

See accompanying Notes.

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Condensed Consolidated Statements of Cash Flows

Supplemental Cash Flow Disclosure

(in thousands)

(unaudited)

	Three Months Ended July 31,		Six Months Ended July 31,	
	2015	2014	2015	2014
Supplemental cash flow disclosure:				
Cash paid during the period for:				
Interest	\$20,592	\$8,322	\$28,671	\$16,989
Income taxes, net of tax refunds	\$5,621	\$14,805	\$16,202	\$24,799
Non-cash financing and investing activities:				
Fixed assets acquired under capital leases	\$2,166	\$75,449	\$5,126	\$81,335
Building in progress - leased facility acquired under financing obligation	\$14,636	\$20,288	\$36,859	\$33,048
Fair value of loan assumed on 50 Fremont	\$0	\$0	\$198,751	\$0

See accompanying Notes.

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Notes to Condensed Consolidated Financial Statements

1. Summary of Business and Significant Accounting Policies

Description of Business

Salesforce.com, inc. (the “Company”) is a leading provider of enterprise 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 2016, for example, refer to the fiscal year ending January 31, 2016.

Basis of Presentation

The accompanying condensed consolidated balance sheet as of July 31, 2015 and the condensed consolidated statements of operations, the condensed consolidated statements of comprehensive loss and the condensed consolidated statements of cash flows for the three and six months ended July 31, 2015 and 2014, respectively, are unaudited. The condensed consolidated balance sheet data as of January 31, 2015 was derived from the audited consolidated financial statements that are included in the Company’s fiscal 2015 Form 10-K, which was filed with the Securities and Exchange Commission (the “SEC”) on March 6, 2015. The accompanying statements should be read in conjunction with the audited consolidated financial statements and related notes contained in the Company’s fiscal 2015 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, 2015, and its results of operations, including its comprehensive loss, and its cash flows for the three and six months ended July 31, 2015 and 2014. All adjustments are of a normal recurring nature. The results for the three and six months ended July 31, 2015 are not necessarily indicative of the results to be expected for any subsequent quarter or for the fiscal year ending January 31, 2016.

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 fair value of convertible notes,
- the fair value of stock awards issued and related forfeiture rates,
- the useful lives of intangible assets and property and equipment,
- the valuation of strategic investments and the determination of other-than-temporary impairments, and
- the assessment of determination of impairment of long-lived assets (property and equipment, goodwill and identified intangibles).

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

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 all of the Company's offerings operate on a single platform and are deployed in an identical way, and the Company's chief operating decision maker evaluates the Company's financial information and resources and assesses the performance of these resources on a consolidated basis. Since the Company operates in one operating segment, all required financial segment information can be found in the 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. This allowance is based upon historical loss patterns, the number of days that billings are past due and an evaluation of the potential risk of loss associated with delinquent accounts.

No single customer accounted for more than five percent of accounts receivable at July 31, 2015 and January 31, 2015. No single customer accounted for five percent or more of total revenue during the three and six months ended July 31, 2015 and 2014.

Geographic Locations

As of July 31, 2015 and January 31, 2015, assets located outside the Americas were 12 percent of total assets.

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

	Three Months Ended July 31,		Six Months Ended July 31,	
	2015	2014	2015	2014
Americas	\$1,202,173	\$940,946	\$2,317,293	\$1,817,323
Europe	286,904	246,532	545,709	477,342
Asia Pacific	145,607	131,073	282,849	250,658
	\$1,634,684	\$1,318,551	\$3,145,851	\$2,545,323

Americas revenue attributed to the United States was approximately 95 percent and 94 percent during the three and six months ended July 31, 2015 and 2014, respectively. No other country represented more than ten percent of total revenue during the three and six months ended July 31, 2015 and 2014.

Revenue Recognition

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

"Other revenue" consists primarily of training fees.

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

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

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

Subscription and Support Revenues

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

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

Professional Services and Other Revenues

The 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.

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

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Deferred Revenue

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

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

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

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	The remaining lease term or up to 10 years

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

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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 and Intangible Assets 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.

Long-Lived Assets and Impairment Assessment

The company evaluates long-lived assets for possible impairment whenever events or circumstances indicate that the carrying amount of such assets may not be recoverable. This includes but is not limited to significant adverse changes in business climate, market conditions, or other events that indicate an asset's carrying amount may not be recoverable. 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.

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

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

The Company additionally has entered into subleases for unoccupied leased office space. Losses are recognized in the period the sublease is executed. Any sublease payments received in excess of the straight-line rent payments for the

sublease are recorded in other income (expense).

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Accounting for Stock-Based Expense

The Company recognizes stock-based expenses related to stock options and restricted stock awards on a straight-line basis over the requisite service period of the awards, which is generally the vesting term of four years. The Company recognizes stock-based expenses related to shares issued pursuant to its Amended and Restated 2004 Employee Stock Purchase Plan (“ESPP” or “2004 Employee Stock Purchase Plan”) on a straight-line basis over the offering period, which is 12 months. Stock-based expenses 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 July 31,		Six Months Ended July 31,			
	2015	2014	2015	2014		
Stock Options						
Volatility	35	% 37	% 35-37	% 37		%
Estimated life	3.6 years	3.5 years	3.6 years	3.5 years		
Risk-free interest rate	1.31- 1.42	% 1.25- 1.46	% 1.13- 1.42	% 1.20- 1.46		%
Weighted-average fair value per share of grants	\$20.24	\$15.81	\$19.81	\$16.15		
	Three Months Ended July 31,		Six Months Ended July 31,			
	2015	2014	2015	2014		
ESPP						
Volatility	34	% 34-35	% 34	% 34-35		%
Estimated life	0.75 years	0.75 years	0.75 years	0.75 years		
Risk-free interest rate	0.06- 0.27	% 0.07- 0.16	% 0.06- 0.27	% 0.07- 0.16		%
Weighted-average fair value per share of grants	\$19.30	\$14.53	\$19.30	\$14.53		

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.

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 condensed consolidated statement of operations in the period that includes the enactment date.

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.

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.

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In July 2015, the United States Tax Court (the “Court”) issued an opinion favorable to Altera Corporation (“Altera”) with respect to Altera’s litigation with the Internal Revenue Service (“IRS”). The litigation relates to the treatment of stock-based compensation expense in an inter-company cost-sharing arrangement with Altera’s foreign subsidiary. In its opinion, the Court accepted Altera’s position of excluding stock-based compensation from its inter-company cost-sharing arrangement. Because there is uncertainty related to the IRS response to the Court’s opinion, the final resolution of this litigation, and the potential favorable benefits to the Company, the Company did not record any benefit for the three months ended July 31, 2015. Management will continue to monitor developments related to this case and the potential impact of those developments on our current and future financial statements.

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. The FASB deferred the effective date for the new revenue reporting standard for entities reporting under U.S. GAAP for one year. In accordance with the deferral, ASU 2014-09 will be effective for fiscal 2019, including interim periods within that reporting period. 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 condensed consolidated financial statements and has not determined whether the effect will be material to either its revenue results or its deferred commissions balances.

Reclassification

Certain reclassifications to the fiscal 2015 balances were made to conform to the current period presentation in the Balance Sheet. These reclassifications include strategic investments and other assets, net.

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2. Investments

Marketable Securities

At July 31, 2015, 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	\$579,895	\$816	\$(992)	) \$579,719
U.S. treasury securities	108,471	193	(7)	) 108,657
Mortgage backed obligations	59,620	93	(406)	) 59,307
Asset backed securities	166,818	93	(150)	) 166,761
Municipal securities	36,388	102	(44)	) 36,446
Foreign government obligations	2,091	16	(1)	) 2,106
U.S. agency obligations	14,172	11	(3)	) 14,180
Covered bonds	10,224	212	0	) 10,436
Total marketable securities	\$977,679	\$1,536	\$(1,603)	) \$977,612

At January 31, 2015, 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	\$605,724	\$3,031	\$(481)	) \$608,274
U.S. treasury securities	73,226	257	(1)	) 73,482
Mortgage backed obligations	44,181	159	(415)	) 43,925
Asset backed securities	120,049	131	(43)	) 120,137
Municipal securities	36,447	115	(25)	) 36,537
Foreign government obligations	12,023	278	0	) 12,301
U.S. agency obligations	19,488	26	(4)	) 19,510
Covered bonds	66,816	1,185	0	) 68,001
Total marketable securities	\$977,954	\$5,182	\$(969)	) \$982,167

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

	As of July 31, 2015	January 31, 2015
Recorded as follows:		
Short-term (due in one year or less)	\$81,118	\$87,312
Long-term (due after one year)	896,494	894,855
	\$977,612	\$982,167

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As of July 31, 2015, the following marketable securities were in an unrealized loss position (in thousands):

	Less than 12 Months		12 Months or Greater		Total	Unrealized
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Losses
Corporate notes and obligations	\$322,777	\$(930)	\$17,977	\$(62)	\$340,753	\$(992)
U.S. treasury securities	14,002	(7)	0	0	14,002	(7)
Mortgage backed obligations	36,878	(227)	14,998	(179)	51,876	(406)
Asset backed securities	98,740	(127)	6,230	(23)	104,970	(150)
Municipal securities	8,683	(27)	6,046	(17)	14,729	(44)
Foreign government obligations	1,579	(1)	0	0	1,579	(1)
U.S. agency obligations	2,172	(3)	0	0	2,172	(3)
	\$484,831	\$(1,322)	\$45,251	\$(281)	\$530,081	\$(1,603)

The unrealized losses for each of the fixed rate marketable securities were less than \$36,000. 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, 2015. 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.

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The following table presents information about the Company's assets and liabilities that are measured at fair value as of July 31, 2015 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, 2015
Cash equivalents (1):				
Time deposits	\$ 0	\$ 122,970	\$ 0	\$ 122,970
Money market mutual funds	289,410	0	0	289,410
Marketable securities:				
Corporate notes and obligations	0	579,719	0	579,719
U.S. treasury securities	0	108,657	0	108,657
Mortgage backed obligations	0	59,307	0	59,307
Asset backed securities	0	166,761	0	166,761
Municipal securities	0	36,446	0	36,446
Foreign government obligations	0	2,106	0	2,106
U.S. agency obligations	0	14,180	0	14,180
Covered bonds	0	10,436	0	10,436
Foreign currency derivative contracts (2)	0	3,621	0	3,621
Total Assets	\$ 289,410	\$ 1,104,203	\$ 0	\$ 1,393,613
Liabilities				
Foreign currency derivative contracts (3)	\$ 0	\$(2,213)	\$ 0	\$(2,213)
Total Liabilities	\$ 0	\$(2,213)	\$ 0	\$(2,213)

(1)Included in "cash and cash equivalents" in the accompanying condensed consolidated balance sheet as of July 31, 2015, in addition to \$677.0 million of cash.

(2)Included in "prepaid expenses and other current assets" in the accompanying condensed consolidated balance sheet as of July 31, 2015.

(3)Included in "accounts payable, accrued expenses and other liabilities" in the condensed consolidated balance sheet as of July 31, 2015.

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The following table presents information about the Company's assets and liabilities that are measured at fair value as of January 31, 2015 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, 2015
Cash equivalents (1):				
Time deposits	\$ 0	\$292,487	\$0	\$292,487
Money market mutual funds	13,983	0	0	13,983
Marketable securities:				
Corporate notes and obligations	0	608,274	0	608,274
U.S. treasury securities	0	73,482	0	73,482
Mortgage backed obligations	0	43,925	0	43,925
Asset backed securities	0	120,137	0	120,137
Municipal securities	0	36,537	0	36,537
Foreign government obligations	0	12,301	0	12,301
U.S. agency obligations	0	19,510	0	19,510
Covered bonds	0	68,001	0	68,001
Foreign currency derivative contracts (2)	0	10,611	0	10,611
Total Assets	\$ 13,983	\$1,285,265	\$0	\$1,299,248
Liabilities				
Foreign currency derivative contracts (3)	\$ 0	\$5,694	\$0	\$5,694
Total Liabilities	\$ 0	\$5,694	\$0	\$5,694

(1)Included in "cash and cash equivalents" in the accompanying condensed consolidated balance sheet as of January 31, 2015, in addition to \$601.6 million of cash.

(2)Included in "prepaid expenses and other current assets" in the accompanying condensed consolidated balance sheet as of January 31, 2015.

(3)Included in "accounts payable, accrued expenses and other liabilities" in the accompanying condensed consolidated balance sheet as of January 31, 2015.

Derivative Financial Instruments

The Company enters into foreign currency derivative contracts with financial institutions to reduce foreign exchange risk. The Company uses forward currency derivative contracts to minimize the Company's exposure to balances primarily denominated in British pounds, Euros, Japanese yen, Canadian dollars and Australian dollars. The Company's foreign currency derivative contracts, which are not designated as hedging instruments, are used to reduce the exchange rate risk associated primarily with intercompany receivables and payables. The Company's derivative financial instruments program is not designated for trading or speculative purposes. As of July 31, 2015 and January 31, 2015, the foreign currency derivative contracts that were not settled were 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.

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

	As of July 31, 2015	January 31, 2015
Notional amount of foreign currency derivative contracts	\$762,454	\$942,086
Fair value of foreign currency derivative contracts	\$1,408	\$4,917

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, 2015	January 31, 2015
Derivative Assets			
Derivatives not designated as hedging instruments:			
Foreign currency derivative contracts	Prepaid expenses and other current assets	\$3,621	\$10,611
Derivative Liabilities			
Derivatives not designated as hedging instruments:			
Foreign currency derivative contracts	Accounts payable, accrued expenses and other liabilities	\$2,213	\$5,694

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, 2015 and 2014, 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, 2015	2014
Foreign currency derivative contracts	Other expense	\$9,494	\$(2,914)

Derivatives Not Designated as Hedging Instruments	Location	Gains (Losses) on Derivative Instruments Recognized in Income	
		Six Months Ended	
		July 31, 2015	2014
Foreign currency derivative contracts	Other expense	\$14,069	\$(2,006)

Strategic Investments

The Company's strategic investments are composed of marketable equity securities and non-marketable equity and debt securities. Marketable equity securities are measured using quoted prices in their respective active markets and the non-marketable equity and debt securities are recorded at cost value.

As of July 31, 2015, the Company had six investments in marketable equity securities that have a fair value of \$28.2 million, which includes an unrealized gain of \$20.4 million. As of January 31, 2015, the Company had four investments in marketable equity securities that had a fair value of \$17.8 million, which included an unrealized gain of

\$13.1 million. As these are investments in publicly-held companies and are recorded at fair value, the unrealized gain is recorded in the condensed consolidated balance sheets within strategic investments and accumulated other comprehensive loss.

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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. 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, 2015 and January 31, 2015, the cost of the Company's investments in privately-held companies was \$449.7 million and \$158.0 million, respectively. These investments are presented on the condensed consolidated balance sheets within strategic investments. The estimated fair value of the Company's investments in privately-held companies was approximately \$631.0 million and \$280.0 million as of July 31, 2015 and January 31, 2015, respectively. Due to the fact that the Company's investments in privately-held companies are measured using the cost method of accounting, the unrealized gains of \$181.3 million and \$122.0 million as of July 31, 2015 and January 31, 2015, respectively, are not recorded on the condensed consolidated balance sheets within strategic investments and accumulated other comprehensive loss.

Investment Income

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

	Three Months Ended July 31,		Six Months Ended July 31,	
	2015	2014	2015	2014
Interest income	\$3,169	\$2,567	\$6,219	\$4,331
Realized gains	813	229	2,940	346
Realized losses	(699	) (141	) (1,315	) (244
Total investment income	\$3,283	\$2,655	\$7,844	\$4,433

Reclassification adjustments out of accumulated other comprehensive loss into net income (loss) were immaterial for the three and six months ended July 31, 2015 and 2014, respectively.

3. Property and Equipment**Property and Equipment**

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

	As of	
	July 31, 2015	January 31, 2015
Land	\$183,888	\$0
Buildings	581,036	125,289
Computers, equipment and software	1,231,106	1,171,762
Furniture and fixtures	77,240	71,881
Leasehold improvements	419,040	376,761
	\$2,492,310	\$1,745,693
Less accumulated depreciation and amortization	(767,126	) (619,827