Zendesk, Inc.
Form 10-Q
May 05, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2016

OR

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

For the transition period from to

Commission File Number: 001-36456

ZENDESK, INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware	26-4411091
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1019 Market Street

San Francisco, California 94103

(Address of principal executive offices)

415.418.7506

(Registrant’s Telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 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 x 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 x	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 x

As of April 30, 2016 there were 91,743,091 shares of the registrant’s common stock outstanding.

ZENDESK, INC.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the federal securities laws, which statements involve substantial risks and uncertainties. Forward-looking statements generally relate to future events or our future financial or operating performance. In some cases, you can identify forward-looking statements because they contain words such as “may,” “will,” “should,” “might,” “expects,” “plans,” “anticipates,” “could,” “i “target,” “projects,” “contemplates,” “believes,” “estimates,” “predicts,” “potential,” or “continue” or the negative of these wor other similar terms or expressions that concern our expectations, strategy, plans, or intentions. Forward-looking statements contained in this Quarterly Report on Form 10-Q include, but are not limited to, statements about:

- our future financial performance, including our revenue, cost of revenue, gross profit, operating expenses, ability to generate positive cash flow, and ability to achieve and maintain profitability;
- the sufficiency of our cash and cash equivalents, and marketable securities to meet our liquidity needs;
- our ability to attract and retain customers to use our customer service platform, live chat software, and analytics software, and to optimize the pricing for such software;
- the evolution of technology affecting our platform, services, and markets;
- our ability to innovate and provide a superior customer experience;
- our ability to successfully expand in our existing markets and into new markets;
- the attraction and retention of qualified employees and key personnel;
- worldwide economic conditions and their impact on information technology spending;
- our ability to effectively manage our growth and future expenses;
- our ability to successfully offer our live chat software and our analytics software as standalone services or further integrate such software with our customer service platform;
- our ability to maintain, protect, and enhance our intellectual property;
- our ability to comply with modified or new laws and regulations applying to our business, including privacy and data security regulations;
- our ability to securely maintain customer data;
- our ability to maintain and enhance our brand; and
- the increased expenses and administrative workload associated with being a public company.

We caution you that the foregoing list does not contain all of the forward-looking statements made in this Quarterly Report on Form 10-Q.

You should not rely upon forward-looking statements as predictions of future events. We have based the forward-looking statements contained in this Quarterly Report on Form 10-Q primarily on our current expectations and projections about future events and trends that we believe may affect our business, financial condition, operating results, and prospects. The outcome of the events described in these forward-looking statements is subject to risks, uncertainties, and other factors described in the section titled “Risk Factors” and elsewhere in this Quarterly Report on Form 10-Q. Moreover, we operate in a very competitive and rapidly changing environment. New risks and uncertainties emerge from time to time, and it is not possible for us to predict all risks and uncertainties that could have an impact on the forward-looking statements contained in this Quarterly Report on Form 10-Q. We cannot assure you that the results, events, and circumstances reflected in the forward-looking statements will be achieved or occur, and actual results, events, or circumstances could differ materially from those described in the forward-looking statements.

The forward-looking statements made in this Quarterly Report on Form 10-Q relate only to events as of the date on which the statements are made. We undertake no obligation to update any forward-looking statements made in this Quarterly Report on Form 10-Q to reflect events or circumstances after the date of this Quarterly Report on Form 10-Q or to reflect new information or the occurrence of unanticipated events, except as required by law. We may not actually achieve the plans, intentions, or expectations disclosed in our forward-looking statements and you should not place undue reliance on our forward-looking statements. Our forward-looking statements do not reflect the potential impact of any future acquisitions, mergers, dispositions, joint ventures, or investments we may make.

PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

ZENDESK, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value and shares)

	March 31, 2016 (Unaudited)	December 31, 2015
Assets		
Current Assets:		
Cash and cash equivalents	$ 217,791	$ 216,226
Marketable securities	36,531	29,414
Accounts receivable, net of allowance for doubtful accounts of $900 and $763 as of March 31, 2016 and December 31, 2015, respectively	24,094	26,168
Prepaid expenses and other current assets	11,984	11,423
Total current assets	290,400	283,231
Marketable securities, noncurrent	18,387	22,336
Property and equipment, net	55,543	56,540
Goodwill and intangible assets, net	56,746	57,050
Other assets	4,606	3,529
Total assets	$ 425,682	$ 422,686
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$ 6,497	$ 9,332
Accrued liabilities	11,626	9,742
Accrued compensation and related benefits	15,193	14,115
Deferred revenue	90,551	84,210
Total current liabilities	123,867	117,399
Deferred revenue, noncurrent	1,434	1,405
Other liabilities	10,530	10,592
Total liabilities	135,831	129,396
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Preferred stock	—	—
Common stock	917	905
Additional paid-in capital	531,431	511,183
Accumulated other comprehensive income (loss)	1,247	(2,225)
Accumulated deficit	(243,092)	(215,921)
Treasury stock at cost (0.5 million shares as of March 31, 2016 and	(652)	(652)

December 31, 2015)		
Total stockholders' equity	289,851	293,290
Total liabilities and stockholders' equity	$ 425,682	$422,686

See Notes to Condensed Consolidated Financial Statements.

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ZENDESK, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(Unaudited)

	Three Months Ended March 31, 2016	2015
Revenue	$68,459	$42,234
Cost of revenue [1]	21,516	14,290
Gross profit	46,943	27,944
Operating expenses [1]		
Research and development	21,597	13,259
Sales and marketing	36,172	23,403
General and administrative	15,861	10,127
Total operating expenses	73,630	46,789
Operating loss	(26,687)	(18,845)
Other expense, net	(70)	(230)
Loss before provision for income taxes	(26,757)	(19,075)
Provision for income taxes	414	93
Net loss	(27,171)	(19,168)
Net loss per share, basic and diluted	$(0.30)	$(0.25)
Weighted-average shares used to compute net loss per share, basic and diluted	90,519	76,338

(1) Includes share-based compensation expense as follows:

	Three Months Ended March 31, 2016	2015
Cost of revenue	$1,633	$891
Research and development	6,627	4,064
Sales and marketing	5,439	2,432
General and administrative	3,996	2,842

See Notes to Condensed Consolidated Financial Statements.

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ZENDESK, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(In thousands)

(Unaudited)

	Three Months Ended March 31, 2016	2015
Net loss	$(27,171)	$(19,168)
Other comprehensive loss, net of tax:		
Net change in unrealized gain on available-for-sale investments	129	40
Foreign currency translation gain (loss)	733	(440)
Net change in unrealized gain on derivative instruments	2,610	—
Comprehensive loss	$(23,699)	$(19,568)

See Notes to Condensed Consolidated Financial Statements.

ZENDESK, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Three Months Ended March 31, 2016	2015
Cash flows from operating activities		
Net loss	$(27,171)	$(19,168)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	6,526	4,223
Share-based compensation	17,695	10,229
Other	403	172
Changes in operating assets and liabilities:		
Accounts receivable	1,898	(635)
Prepaid expenses and other current assets	862	(793)
Other assets and liabilities	(383)	(638)
Accounts payable	(1,851)	(1,012)
Accrued liabilities	2,307	1,323
Accrued compensation and related benefits	(2,066)	(2,837)
Deferred revenue	6,369	3,941
Net cash provided by (used in) operating activities	4,589	(5,195)
Cash flows from investing activities		
Purchases of property and equipment	(3,249)	(3,356)
Internal-use software development costs	(1,351)	(1,317)
Purchases of marketable securities	(20,795)	(14,801)
Proceeds from maturities of marketable securities	10,051	7,520
Proceeds from sale of marketable securities	7,604	6,141
Cash paid for the acquisition of Zopim, net of cash acquired	—	(548)
Net cash used in investing activities	(7,740)	(6,361)
Cash flows from financing activities		
Proceeds from follow-on public offering, net of issuance costs	—	190,794
Proceeds from exercise of employee stock options	1,915	2,938
Taxes paid related to net share settlement of equity awards	(189)	(82)
Proceeds from employee stock purchase plan	3,144	2,468
Principal payments on debt	—	(753)
Principal payments on capital lease obligations	—	(10)
Net cash provided by financing activities	4,870	195,355
Effect of exchange rate changes on cash and cash equivalents	(154)	158
Net increase in cash and cash equivalents	1,565	183,957
Cash and cash equivalents at the beginning of period	216,226	80,265

Cash and cash equivalents at the end of period	$217,791	$264,222
Supplemental cash flow data:		
Cash paid for interest and income taxes	$168	$122
Non-cash investing and financing activities:		
Balance of property and equipment in accounts payable and accrued expenses	$2,345	$497
Share-based compensation capitalized in internal-use software development costs	$563	$545
Vesting of early exercised stock options	$232	$311
Property and equipment acquired through tenant improvement allowances	$—	$174
Follow-on offering related costs not yet paid for	$—	$605

See Notes to Condensed Consolidated Financial Statements.

ZENDESK, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Overview and Basis of Presentation

Company and Background

Zendesk was founded in Denmark in 2007 and reincorporated in Delaware in April 2009.

Our mission is to help organizations and their customers build better relationships. We are a software development company that provides a SaaS customer service platform that enables our customers to provide tailored support through multiple channels, establish effective self-service support resources, proactively serve customers through customer engagement capabilities, integrate with other applications, and consolidate and analyze data from customer interactions. We also provide SaaS live chat software that can be utilized independently to facilitate proactive communications between organizations and their customers or integrated easily into our platform.

In October 2015, we completed the acquisition of We Are Cloud SAS, or WAC, the maker of BIME Analytics software. With the acquisition, we added technology that we anticipate will allow our customers to understand the ever-increasing diversity of data about their end customers. Over time, we expect this analytics software to become a core technology within our customer service platform, enabling us to further integrate data analytics capabilities across our products. We also expect to continue to sell our analytics software on a standalone basis.

References to Zendesk, the “Company”, “our”, or “we” in these notes refer to Zendesk, Inc. and its subsidiaries on a consolidated basis.

Basis of Presentation

These unaudited condensed consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles, or GAAP, and applicable rules and regulations of the Securities and Exchange Commission, or SEC, regarding interim financial reporting. Certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Therefore, these condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2015, filed on February 26, 2016. There have been no changes to our significant accounting policies described in the Annual Report on Form 10-K that have had a material impact on our condensed consolidated financial statements and related notes.

The consolidated balance sheet as of December 31, 2015 included herein was derived from the audited financial statements as of that date. The unaudited condensed consolidated financial statements reflect all normal recurring adjustments necessary to present fairly the financial position, results of operations, our comprehensive loss and cash flows for the interim periods, but are not necessarily indicative of the results of operations to be anticipated for the full year ending December 31, 2016.

Follow-On Public Offering

In March 2015, we completed a follow-on public offering, in which we issued 8.8 million shares of our common stock at a public offering price of $22.75 per share. We received net proceeds of $190.1 million after deducting underwriting discounts and commissions of $8.7 million and other offering expenses of $0.9 million.

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires management to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenue and expenses during the reported periods.

Significant items subject to such estimates and assumptions include the fair value of share-based awards, acquired intangible assets and goodwill, unrecognized tax benefits, the useful lives of acquired intangible assets and property and equipment, and the capitalization and estimated useful life of our capitalized internal-use software.

These estimates are based on information available as of the date of the financial statements; therefore, actual results could differ from those estimates.

Concentrations of Risk

As of March 31, 2016, no customers represented 10% or greater of our total accounts receivable balance. There were no customers that individually exceeded 10% of our revenue during the three months ended March 31, 2016 or 2015.

Recently Issued and Adopted Accounting Pronouncements

In May 2014, the FASB issued new revenue guidance that provides principles for recognizing revenue to which an entity expects to be entitled for the transfer of promised goods or services to customers. In August 2015, the FASB deferred the effective date of adoption by one year. As currently issued and amended, the new guidance is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period, though early adoption is permitted for annual reporting periods beginning after December 15, 2016. The amendment may be applied retrospectively to each prior period presented, or with the cumulative effect recognized as of the date of initial adoption. We have not yet selected a transition method and continue to evaluate the effect of the standard on our consolidated financial statements, including revenue and commissions.

In September 2015, the FASB issued ASU 2015-16 “Simplifying the Accounting for Measurement-Period Adjustments,” which requires that an acquirer in a business combination recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The new standard is required to be applied prospectively. We adopted this guidance in the first quarter of 2016. The adoption of this standard did not have a material impact on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02 regarding ASC Topic 842 "Leases." This new standard requires lessees to recognize most leases on their balance sheets as lease liabilities with corresponding right-of-use assets and eliminates certain real estate-specific provisions. The new guidance is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period. Early adoption is permitted. We are currently evaluating the impact of this standard on our consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09 regarding Topic 718 "Compensation - Stock Compensation." This amendment changes certain aspects of accounting for share-based compensation to employees, including the recognition of income tax effects of awards when the awards vest or are settled, requirements on net share settlement to cover tax withholding, and accounting for forfeitures. The new guidance is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is permitted. We are currently evaluating the impact of this standard on our consolidated financial statements.

Note 2. Business Combination

On October 13, 2015, we completed the acquisition of WAC, the maker of BIME Analytics software. We acquired 100 percent of the outstanding shares of WAC in exchange for purchase consideration of $46.4 million in cash, including working capital adjustments. As partial security for standard indemnification obligations, $7.0 million of the consideration will be held in escrow for a period of up to 18 months, with a portion to be released 12 months following the closing of the acquisition. We incurred transaction costs of $1.0 million in connection with the acquisition. The transaction costs were expensed as incurred and recognized within general and administrative expenses.

The fair value of assets acquired and liabilities assumed was based on a preliminary valuation and purchase price, and our estimates and assumptions are subject to change within the measurement period. The primary areas that remain preliminary relate to the fair values of certain tangible assets and liabilities acquired and residual goodwill. The total purchase price was allocated to assets acquired and liabilities assumed as set forth below (in thousands). During the three months ended March 31, 2016, we made adjustments of $37,000 to the preliminary purchase price allocation related to certain tangible assets and liabilities acquired. The excess of the purchase price over the net assets acquired was recorded as goodwill. Goodwill generated from the acquisition is primarily attributable to expected synergies, including cost savings from integrating the analytics technology with our customer service platform and the opportunity to sell the analytics software alongside our existing products. Goodwill is not expected to be deductible for income tax purposes. Goodwill will not be amortized but instead will be tested for impairment at least annually and more frequently if certain indicators of impairment are present.

Net tangible assets acquired	$2,269
Net deferred tax liability recognized	(1,979)
Identifiable intangible assets:	
Developed technology	8,800
Customer relationships	500
Goodwill	36,767
Total purchase price	$46,357

The developed technology and customer relationship intangible assets were each assigned useful lives of 4.5 years.

In connection with the acquisition, we entered into retention arrangements with certain employees of WAC, pursuant to which we issued RSUs for approximately 0.5 million shares of our common stock, most of which vest in three annual installments from the date of acquisition. The expense related to the RSUs is accounted for as share-based compensation expense over the required service periods and was not included in the purchase consideration.

The results of operations of WAC have been included in our consolidated financial statements from the date of the acquisition.

Note 3. Financial Instruments

Investments

The following tables present information about our cash equivalents and marketable securities measured at fair value on a recurring basis as of March 31, 2016 and December 31, 2015 based on the three-tier fair value hierarchy (in thousands):

Fair Value Measurement at
March 31, 2016

	Level 1	Level 2	Total
Description			
Corporate securities	$—	$29,696	$29,696
Money market funds	18,556	—	18,556
Asset-backed securities	—	10,025	10,025
U.S. treasury securities	—	9,211	9,211
Commercial paper	—	3,985	3,985
Agency securities	—	2,001	2,001
Total	$18,556	$54,918	$73,474
Included in cash and cash equivalents			$18,556
Included in marketable securities			$54,918

	Fair Value Measurement at December 31, 2015		
	Level 1	Level 2	Total
Description			
Corporate securities	$—	$31,761	$31,761
Money market funds	21,338	—	21,338
Asset-backed securities	—	7,998	7,998
Commercial paper	—	5,992	5,992
U.S. treasury securities	—	4,001	4,001
Agency securities	—	1,998	1,998
Total	$21,338	$51,750	$73,088
Included in cash and cash equivalents			$21,338
Included in marketable securities			$51,750

As of March 31, 2016 and December 31, 2015, there were no securities within Level 3 of the fair value hierarchy. There were no transfers between fair value measurement levels during the three months ended March 31, 2016. Gross unrealized gains or losses for cash equivalents and marketable securities as of March 31, 2016 and December 31, 2015 were not material. As of March 31, 2016 and December 31, 2015, there were no securities that were in an unrealized loss position for more than 12 months.

The following table classifies our marketable securities by contractual maturity as of March 31, 2016 and December 31, 2015 (in thousands):

	March 31, 2016	December 31, 2015
Due in one year or less	$36,531	$ 29,414
Due after one year	18,387	22,336
Total	$54,918	$ 51,750

For certain other financial instruments, including accounts receivable, accounts payable and other current liabilities, the carrying amounts approximate their fair value due to the relatively short maturity of these balances.

Derivative Instruments and Hedging

Our foreign currency exposures typically arise from foreign operations and sales in foreign currencies for subscriptions to our customer service platform. In September 2015, we implemented a hedging program to mitigate the impact of foreign currency fluctuations on our future cash flows and earnings. We enter into foreign currency forward contracts with certain financial institutions and designate those hedges as cash flow hedges. Our foreign currency forward contracts generally have maturities of 15 months or less but can extend up to 24 months. As of March 31, 2016, the balance of other accumulated comprehensive income included an unrealized gain of $1.9 million related to the effective portion of changes in the fair value of foreign currency forward contracts designated as cash flow hedges. We expect to reclassify $1.1 million from accumulated other comprehensive income into earnings over the next 12 months associated with our cash flow hedges.

The following tables present information about derivative instruments on our consolidated balance sheets as of March 31, 2016 and December 31, 2015 (in thousands):

	March 31, 2016			
	Asset Derivatives		Liability Derivatives	
Derivative Instrument	Balance Sheet Location	Fair Value (Level 2)	Balance Sheet Location	Fair Value (Level 2)
Foreign currency forward contracts	Other current assets			