VALUERICH INC
Form 3
July 09, 2007

FORM 3

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

OMB APPROVAL

OMB Number:	3235-0104
Expires:	January 31, 2005
Estimated average burden hours per response...	0.5

INITIAL STATEMENT OF BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

(Print or Type Responses)

1. Name and Address of Reporting Person *
Â Lowenstein Gregg W
(Last) (First) (Middle)

1804 N. DIXIE HIGHWAY, SUITE A,Â C/O VALUERICH, INC.
(Street)

WEST PALM BEACH,Â FLÂ 33407
(City) (State) (Zip)

2. Date of Event Requiring Statement (Month/Day/Year)
06/25/2007

3. Issuer Name **and** Ticker or Trading Symbol
VALUERICH INC [IVA]

4. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

_____ Director _____ 10% Owner
__X__ Officer (give title below) _____ Other (specify below)
Vice President of Sales

5. If Amendment, Date Original Filed(Month/Day/Year)

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Beneficially Owned

1.Title of Security (Instr. 4)	2. Amount of Securities Beneficially Owned (Instr. 4)	3. Ownership Form: Direct (D) or Indirect (I) (Instr. 5)	4. Nature of Indirect Beneficial Ownership (Instr. 5)
Common Stock, par value $.01 per share	50,000	D	Â

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

SEC 1473 (7-02)

Persons who respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

Table II - Derivative Securities Beneficially Owned (*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 4)	2. Date Exercisable and Expiration Date (Month/Day/Year)	3. Title and Amount of Securities Underlying Derivative Security (Instr. 4)	4. Conversion or Exercise Price of Derivative	5. Ownership Form of Derivative Security:	6. Nature of Indirect Beneficial Ownership (Instr. 5)

Date Exercisable	Expiration Date	Title	Amount or Number of Shares	Security	Direct (D) or Indirect (I) (Instr. 5)

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
Lowenstein Gregg W 1804 N. DIXIE HIGHWAY, SUITE A C/O VALUERICH, INC. WEST PALM BEACH,Â FLÂ 33407	Â	Â	Â Vice President of Sales	Â

Signatures

/s/ Gregg W. Lowenstein	07/09/2007
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 5(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *See* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. mal;text-transform:none;font-variant: normal;">

(In thousands)

Cash provided by (used in) operating activities

$

2,090

$

4,005

$

(5,096

)

Cash used in investing activities

(71,297

)

(24,186

)

(7,119

)

Cash provided by financing activities

95,768

25,216

46,705

To date, we have financed our operations primarily through sales of equity securities. From our inception through December 31, 2014, we have received cash proceeds of $174.4 million from the sale of equity securities, net of issuance costs paid. We have also financed our operations through customer payments for subscription to our customer service platform and live-chat software, as well as borrowings under our credit facility. We believe that our existing cash, cash equivalents, and marketable securities balances together with cash generated from operations and the available balance of our credit facility will be sufficient to meet our working capital and capital expenditure requirements for at least the next 12 months.

Our future capital requirements will depend on many factors including growth in our customer accounts and continued customer expansion, the timing and extent of spending to support product development efforts, the expansion of sales and marketing activities, ongoing investments in our platform infrastructure, and the introduction of new and enhanced products, features and functionality. We may in the future enter into arrangements to acquire or invest in complementary businesses, services and technologies and intellectual property rights. We may be required to seek additional equity or debt financing in order to meet these future capital requirements. In the event that additional financing is required from outside sources, we may not be able to raise it on terms acceptable to us, or at all. If we are unable to raise additional capital when desired, our business, results of operations and financial condition would be adversely affected.

In March 2014, we completed the acquisition of Zopim. The purchase price of approximately $15.8 million ($4.9 million of cash and $10.9 million of our common stock) includes $1.1 million of cash and $2.4 million of common stock consideration held back between 12 and 18 months as partial security for standard indemnification obligations and which are payable in the future under terms specified in the stock purchase agreement. In connection with the acquisition of Zopim, we established a retention plan pursuant to which we will pay up to $13.9 million in cash and equity consideration over two and three years, respectively, to Zopim employees in connection with their continued employment.

Prior to the expiration of the lock-up agreements in connection with our IPO, we had elected to net share settle our RSUs by withholding shares and remitting income tax on behalf of the applicable employees. During the year ended December 31, 2014, cash used for tax payments related to net share settlement of RSUs was $2.1 million. Upon the expiration of the lock-up agreements in November 2014, we generally began requiring that employees sell a portion of the shares that they receive upon the vesting of RSUs in order to cover any required withholding taxes (sell-to-cover). We expect this sell-to-cover approach will reduce our cash outflows.

Operating Activities

Our largest source of operating cash inflows is cash collections from our customers for subscription services. Our primary uses of cash from operating activities are for employee-related expenditures, leased facilities, and hosting fees.

Net cash provided by operating activities in 2014 was $2.1 million, reflecting our net loss of $67.4 million, adjusted by non-cash charges including share-based compensation expense of $32.1 million, depreciation and amortization of

$11.5 million, and changes in our working capital. The changes in our working capital were primarily attributable to an increase in deferred revenue of $22.4 million due to the growth of our subscription services, an increase in accrued compensation liabilities of $5.8 million primarily due to a significant increase in headcount and timing of payments, an increase in other assets and liabilities of $1.7 million due to increased deferred rent, and an increase in accounts payable and accrued liabilities of $1.3 million due to timing of payments and a higher level of expenses consistent with the overall growth of our business. These sources of cash flow were partially offset by an increase in accounts receivable of $3.8 million due to higher customer billings related to the increase in subscription services during the period and an increase in prepaid expenses and other current assets of $1.4 million primarily due to increases in prepaid subscriptions of business software.

Net cash provided by operating activities in 2013 was $4.0 million, reflecting our net loss of $22.6 million, adjusted by non-cash charges including depreciation and amortization of $5.2 million, share-based compensation expense of $4.9 million, and changes in our working capital. The changes in our working capital were primarily attributable to an increase in deferred revenue of $13.9 million due to the growth of our subscription services, an increase in accounts payable and accrued liabilities of $4.1 million due to timing of payments and a higher level of expenses consistent with the overall growth of our business, and an increase in accrued compensation liabilities of $2.0 million primarily due to a significant increase in headcount. These sources of cash flow were partially offset by an increase in accounts receivable of $3.6 million due to higher customer billings related to the increase in subscription services during the period and an increase in prepaid expenses and other current assets of $0.3 million primarily due to increases in prepaid rent.

Net cash used in operating activities in 2012 was $5.1 million, reflecting our net loss of $24.4 million, adjusted by non-cash charges including share-based compensation expense of $9.6 million and depreciation and amortization of $2.5 million, and changes in our working capital. The changes in our working capital were primarily attributable to an increase in deferred revenue of $7.7 million due to the growth of our subscription services, an increase in accrued compensation liabilities of $1.6 million, primarily due to increased headcount, and an increase in accounts payable and accrued liabilities of $1.1 million due to increased accrual for taxes and timing of payments. These sources of cash flow were partially offset by an increase in prepaid expenses of $1.6 million primarily due to retention-related compensation, which were amortized as compensation expense over the required service period and an increase in accounts receivable of $1.4 million due to higher customer billings related to the increase in subscription services during the period.

Investing Activities

Net cash used in investing activities in 2014 of $71.3 million was primarily attributable to purchases of marketable securities of $54.3 million, purchases of property and equipment of $21.7 million primarily associated with leasehold improvements related to our new offices and hosting equipment, capitalized internal-use software costs of $8.0 million associated with the development of additional features and functionality of our platform, and payments of $1.9 million for the acquisition of Zopim, net of cash acquired. The use of cash in investing activities was partially offset by the sale and maturities of marketable securities of $14.5 million.

Net cash used in investing activities in 2013 of $24.2 million was primarily attributable to purchases of marketable securities of $12.4 million, purchases of property and equipment of $7.1 million primarily associated with hosting equipment to build out our self-managed colocation data centers, and capitalized internal-use software costs of $4.7 million associated with the development of additional features and functionality of our platform.

Net cash used in investing activities in 2012 of $7.1 million was primarily attributable to purchases of property and equipment of $3.6 million to accommodate headcount growth and to build out our self-managed colocation data centers, and capitalized internal-use software costs of $3.5 million associated with an upgrade of our platform introduced in the third quarter of 2012 and the development of additional features and functionality.

Financing Activities

During 2014, cash provided by financing activities of $95.8 million was primarily attributable to net proceeds from the IPO of $103.1 million, proceeds from the issuance of common stock associated with our employee equity plans of $11.6 million, and borrowings under our credit facility of $3.9 million. Cash provided by financing activities was partially offset by principal payments on our credit facility of $20.7 million and payments for withholding taxes related to the net share settlement of RSUs of $2.1 million.

During 2013, cash provided by financing activities of $25.2 million was primarily attributable to proceeds from borrowings under our credit facility of $23.8 million and proceeds from exercise of stock options of $1.8 million,

partially offset by principal payments on capital lease obligations of $0.3 million.

During 2012, cash provided by financing activities of $46.7 million was primarily attributable to net proceeds from issuance of our Series D redeemable convertible preferred stock of $44.9 million and proceeds from exercise of stock options of $2.1 million, partially offset by principal payments on capital lease obligations of $0.3 million.

54

Contractual Obligations and Other Commitments

Our principal commitments consist of obligations under our operating leases for office space, contractual commitments for services related to our colocation data centers and other support services, and credit facility. The following table summarizes our contractual obligations as of December 31, 2014 (in thousands):

	Total	Less than 1 Year	1 to 3 Years	3 to 5 Years	More than 5 Years
Contractual Obligations:					
Debt Obligations	$6,952	$3,041	$3,911	$-	$-
Operating lease obligations	47,342	7,025	14,002	13,608	12,707
Purchase obligations	4,389	2,252	2,137	-	-
Total contractual obligations	$58,683	$12,318	$20,050	$13,608	$12,707

Off-Balance Sheet Arrangements

Through December 31, 2014, we did not have any relationships with unconsolidated organizations or financial partnerships, such as structured finance or special purpose entities that would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Quantitative and Qualitative Disclosures about Market Risk

Foreign Currency Exchange Risk

We conduct transactions, particularly intercompany transactions, in foreign currencies, primarily the British Pound Sterling, Euro, Australian Dollar, Danish Krone, Singapore Dollar, Japanese Yen, Philippine peso, and Brazilian Real. Except for our Singapore subsidiary, our international subsidiaries maintain certain current asset and current liability balances that are denominated in currencies other than the functional currencies of these entities, which is the U.S. dollar. Our Singapore subsidiary’s functional currency is the Singapore Dollar. Changes in the value of foreign currencies relative to the U.S. dollar can affect our revenue, operating expenses, and other expenses as expressed in the U.S dollar. While we have primarily transacted with customers in the U.S. dollar, we have also historically transacted in foreign currencies for subscriptions to our customer service platform and expect to significantly expand the number of transactions with customers that are denominated in foreign currencies in the near future.

Foreign currency gains and losses were not significant for the years ended December 31, 2014, 2013, and 2012. While we have not engaged in hedging of our foreign currency transactions to date, we are currently evaluating the costs and benefits of initiating such a program and may, in the future, hedge selected significant transactions denominated in currencies other than the U.S. dollar.

Interest Rate Sensitivity

We had cash, cash equivalents and marketable securities totaling $131.7 million at December 31, 2014, of which $72.8 million was invested in corporate bonds, money market funds, asset-backed securities, commercial paper and U.S. treasury securities. The cash and cash equivalents are held for working capital purposes. Our investments in marketable securities 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 affected 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 fluctuate 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.

As of December 31, 2014, we do not believe that an increase or decrease in interest rates of ten percent (10%) would have a material effect on the value of our cash equivalents and portfolio of marketable securities. Fluctuations in the value of our cash equivalents and portfolio of marketable 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 prior to maturity.

55

Critical Accounting Polices and Estimates

We prepare our consolidated financial statements in accordance with United States generally accepted accounting principles, or GAAP. In the preparation of these consolidated financial statements, we are required to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, costs and expenses, and related disclosures. To the extent that there are material differences between these estimates and actual results, our financial condition or results of operations would be affected. We base our estimates on past experience and other assumptions that we believe are reasonable under the circumstances, and we evaluate these estimates on an ongoing basis. We refer to accounting estimates of this type as critical accounting policies and estimates, which we discuss below.

Revenue Recognition

We generate substantially all of our revenue from subscription services, which are comprised of subscription fees from customer accounts on our customer service platform and, to a lesser extent, live chat software. Arrangements with customers do not provide the customer with the right to take possession of the software supporting our customer service platform or live chat software at any time, and are therefore accounted for as service contracts. Subscription service arrangements are generally non-cancelable and do not provide for refunds to customers in the event of cancellations or any other right of return. We record revenue net of sales or excise taxes.

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

- 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.

Subscription revenue is recognized on a straight-line basis over the contractual term of the arrangement beginning on the date that our service is made available to the customer. Payments received in advance of services being rendered are recorded as deferred revenue and recognized on a straight-line basis over the requisite service period.

Certain customers have arrangements that provide for a maximum number of users over the contract term, with usage measured monthly. Revenue for these arrangements is recognized ratably over the contract terms. Incremental fees are incurred when the maximum number of users is exceeded, and any incremental fees are recognized as revenue ratably over the remaining contractual term.

We derive an immaterial amount of revenue from implementation, voice, and training services, for which we recognize revenue upon completion.

Capitalized Internal-Use Software Costs

We capitalize certain development costs incurred in connection with software development for our platform and software used in operations. Costs incurred in the preliminary stages of development are expensed as incurred. Once software has reached the development stage, internal and external costs, if direct and incremental, are capitalized until the software is substantially complete and ready for its intended use. Capitalization ceases upon completion of all substantial testing. We also capitalize costs related to specific upgrades and enhancements when it is probable the expenditures will result in additional functionality. Capitalized costs are recorded as part of property and equipment. Maintenance and training costs are expensed as incurred.

Capitalized internal-use software is amortized on a straight-line basis over its estimated useful life and recorded in cost of revenue within the accompanying consolidated statements of operations. The weighted-average useful life of our capitalized internal-use software was 3.2 years as of December 31, 2014. We evaluate the useful lives of these assets and test for impairment whenever events or changes in circumstances occur that could impact the recoverability

of these assets. There were no impairments to internal-use software during the years ended December 31, 2014, 2013 and 2012.

56

Business Combination and Valuation of Goodwill and Purchased Intangible Assets

When we acquire a business, we allocate the purchase price to the net tangible and identifiable intangible assets acquired. Any residual purchase price is recorded as goodwill. The allocation of the purchase price requires management to make significant estimates in determining the fair values of assets acquired and liabilities assumed, especially with respect to intangible assets. These estimates can include, but are not limited to, the cash flows that an asset is expected to generate in the future, the appropriate weighted-average cost of capital, and the cost savings expected to be derived from acquiring an asset. These estimates are inherently uncertain and unpredictable.

Goodwill is evaluated for impairment annually in the third quarter, and whenever events or changes in circumstances indicate the carrying value of goodwill may not be recoverable. Triggering events that may indicate impairment include, but are not limited to, a significant adverse change in customer demand or business climate or a significant decrease in expected cash flows.

Purchased intangible assets consist of identifiable intangible assets, primarily developed technology and customer relationships, resulting from our acquisition of Zopim. Purchased intangible assets are recorded at fair value on the date of acquisition and amortized over their estimated useful lives following the pattern in which the economic benefits of the assets will be consumed, generally straight-line. The carrying amounts of our purchased intangible assets are periodically reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of these assets may not be recoverable or that the useful life is shorter than originally estimated.

Share-Based Compensation

Share-based compensation expense to employees is measured based on the fair value of the awards on the grant date and recognized in our consolidated statements of operations over the period during which the employee is required to perform services in exchange for the award (generally the vesting period of the award). We estimate the fair value of stock options granted using the Black-Scholes option valuation model. We measure the fair value of restricted stock units, or RSUs, based on the fair value of the underlying shares on the date of grant. Compensation expense for awards with only service conditions is recognized over the vesting period of the applicable award using the straight-line method.

Prior to our IPO, we granted Performance Awards to our employees that vested upon the satisfaction of both a service condition, generally over four years, and a performance condition. The performance condition, defined as a qualifying liquidation event, was satisfied upon the effectiveness of the registration statement related to our IPO. No share-based compensation expense had been recognized for the Performance Awards prior to the IPO as such qualifying liquidation event was not deemed probable until that time. Upon the satisfaction of the performance condition, we recognized a cumulative share-based compensation expense for the portion of the Performance Awards that had met the service condition. For the year ended December 31, 2014, share-based compensation expense related to the Performance Awards was $12.7 million, using the accelerated attribution method. The remaining unrecognized share-based compensation expense related to the Performance Awards will be recorded over the remaining requisite service period using the accelerated attribution method, net of estimated forfeitures.

We estimate the fair value of stock options granted using the Black-Scholes option valuation model, which requires assumptions, including the fair value of our underlying common stock, expected term, expected volatility, risk-free interest rate and dividend yield of our common stock. These estimates involve inherent uncertainties and the application of management’s judgment. If factors change and different assumptions are used, our share-based compensation expense could be materially different in the future.

These assumptions are estimated as follows:

.

Fair Value of Common Stock. Prior to our IPO in May 2014, our board of directors, with input from management, exercised significant judgment and considered numerous objective and subjective factors to determine the fair value of our common stock as of the date of each option grant. These factors included, but were not limited to: (i) contemporaneous valuations performed by unrelated third-party specialists, (ii) rights, preferences, and privileges of our redeemable convertible preferred stock relative to those of our common stock, (iii) actual operating and financial performance, (iv) relevant precedent transactions involving our capital stock, (v) likelihood of achieving a liquidity event, such as an initial public offering or a sale of our company given prevailing market conditions and the nature and history of our business, (vi) market multiples of comparable companies in our industry, (vii) stage of development, (viii) industry information such as market size and growth, (ix) illiquidity of share-based awards involving securities in a private company, and (x) macroeconomic conditions.

Since our IPO, we have used the market closing price for our common stock as reported on the New York Stock Exchange.

57

- Expected Term. We determine the expected term based on the average period the stock options are expected to remain outstanding generally calculated as the midpoint of the stock options vesting term and contractual expiration period, as we do not have sufficient historical information to develop reasonable expectations about future exercise patterns and post-vesting employment termination behavior.
- Expected Volatility. We determine the price volatility factor based on the historical volatility of publicly traded industry peers. To determine our peer group of companies, we consider public companies in the technology industry and select those that are similar to us in size, stage of life cycle, and financial leverage. We do not rely on implied volatilities of traded options in our industry peers' common stock because the volume of activity is relatively low. We intend to continue to consistently apply this methodology using the same or similar public companies until sufficient historical information regarding the volatility of our own common stock price becomes available, or unless circumstances change such that the identified companies are no longer similar to us, in which case, more suitable companies whose share prices are publicly available would be utilized in the calculation.
- Risk-Free Interest Rate. We base the risk-free interest rate used in the Black-Scholes valuation model on the yield available on U.S. Treasury zero-coupon issues with an equivalent remaining term of the stock options for each stock option group
- Dividend Yield. We have not paid and do not anticipate paying any cash dividends in the foreseeable future and, therefore, use an expected dividend yield of zero.

The following table summarizes the assumptions, other than fair value of our common stock, relating to our stock options granted in the year ended December 31, 2014, 2013, and 2012:

	Year Ended December 31,		
	2014	2013	2012
Expected volatility	54% - 56%	50% - 63%	57% - 59%
Dividend rate	0%	0%	0%
Risk-free interest rate	1.75% - 2.02%	0.63% - 2.02%	0.68% - 1.47%
Expected term (in years)	6.02 - 6.50	4.47 - 6.27	5.28 - 6.27

In addition to the assumptions used in the Black-Scholes option valuation model, we must also estimate a forfeiture rate to calculate the share-based compensation expense for our awards. Our forfeiture rate is based on an analysis of our actual forfeitures. We will continue to evaluate the appropriateness of the forfeiture rate based on actual forfeiture experience, analysis of employee turnover, and other factors. Changes in the estimated forfeiture rate can have a significant impact on our share-based compensation expense as the cumulative effect of adjusting the rate is recognized in the period the forfeiture estimate is changed. If a revised forfeiture rate is higher than the previously estimated forfeiture rate, an adjustment is made that will result in a decrease to the share-based compensation expense recognized in our financial statements. If a revised forfeiture rate is lower than the previously estimated forfeiture rate, an adjustment is made that will result in an increase to the share-based compensation expense recognized in our financial statements.

We will continue to use judgment in evaluating the expected volatility, expected term, and forfeiture rate utilized in our share-based compensation expense calculations on a prospective basis. As we continue to accumulate additional data related to our common stock, we may refine our estimates of expected volatility, expected term, and forfeiture rates, which could materially impact our future share-based compensation expense.

Recently Issued and Adopted Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board or FASB issued Accounting Standards Update No. 2013-11 "Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists," or ASU 2013-11, which provides guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss, or NOL, carryforward, a similar tax loss, or a tax credit carryforward exists. ASU 2013-11 supports the approach for companies to present an unrecognized tax benefit as a reduction of a deferred tax asset for a NOL or tax credit carryforward whenever the NOL or tax credit carryforward would be available to reduce the additional taxable income or tax due if the tax position is disallowed. This approach requires companies to assess whether to net the unrecognized tax benefit with a deferred tax asset as of the reporting date. We adopted this standard for the year ended December 31, 2014, and the adoption did not have a material effect on our financial position, results of operations, or cash flows.

On May 28, 2014, the FASB, issued ASU 2014-09 regarding ASC Topic 606 “Revenue from Contracts with Customers.” This ASU provides principles for recognizing revenue for the transfer of promised goods or services to customers with the consideration to which the entity expects to be entitled in exchange for those goods or services. This ASU will be effective for our fiscal year beginning January 1, 2017. Early adoption is not permitted. We are currently evaluating the accounting, transition, and disclosure requirements of the standard and cannot currently estimate the financial statement impact of adoption.

Item 8. Financial Statements and Supplementary Data.

ZENDESK, INC.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	Page
Report of Ernst & Young, LLP, Independent Registered Public Accounting Firm	61
Consolidated Balance Sheets	62
Consolidated Statements of Operations	63
Consolidated Statements of Comprehensive Loss	64
Consolidated Statements of Redeemable Convertible Preferred Stock and Stockholders’ Equity (Deficit)	65
Consolidated Statements of Cash Flows	66
Notes to Consolidated Financial Statements	67

Report of Ernst & Young, LLP, Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of Zendesk, Inc.

We have audited the accompanying consolidated balance sheets of Zendesk, Inc. as of December 31, 2014 and 2013, and the related consolidated statements of operations, comprehensive loss, consolidated statements of redeemable convertible preferred stock and stockholders' equity (deficit), and cash flows for each of the three years in the period ended December 31, 2014. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Zendesk, Inc. at December 31, 2014 and 2013, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2014, in conformity with U.S. generally accepted accounting principles.

/s/ Ernst & Young LLP

Redwood City, CA

February 17, 2015

61

ZENDESK, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except par value and shares)

	December 31, 2014	December 31, 2013
Assets		
Current Assets:		
Cash and cash equivalents	$80,265	$53,725
Marketable securities	42,204	9,889
Accounts receivable, net of allowance for doubtful accounts of $264 and $282	11,523	7,237
Prepaid expenses and other current assets	5,013	3,008
Total current assets	139,005	73,859
Marketable securities, noncurrent	9,205	2,225
Property and equipment, net	41,895	15,431
Goodwill and intangible assets, net	14,152	—
Other assets	1,531	1,221
Total assets	$205,788	$92,736
Liabilities, redeemable convertible preferred stock, and stockholders' equity (deficit)		
Current liabilities:		
Accounts payable	$4,763	$3,685
Accrued liabilities	7,689	4,648
Accrued compensation and related benefits	11,738	4,618
Deferred revenue	50,908	28,473
Current portion of credit facility	3,041	365
Current portion of capital leases	10	364
Total current liabilities	78,149	42,153
Deferred revenue, noncurrent	823	575
Credit facility, noncurrent	3,911	23,395
Other liabilities	9,199	1,520
Total liabilities	92,082	67,643
Commitments and contingencies (Note 8)		
Redeemable convertible preferred stock, par value $0.01, issuable in series: no shares and 24.0 million shares authorized; no shares and 23.6 million shares issued and outstanding as of December 31, 2014 and 2013, respectively	—	71,369
Stockholders' equity (deficit):		
Preferred stock, par value $0.01 per share: 10.0 million and no shares authorized as of December 31, 2014 and 2013, respectively; no shares issued and outstanding as of December 31, 2014 and 2013	—	—
Common stock, par value $0.01 per share: 400.0 million and 125.0 million shares	755	229

authorized; 76.1 million and 23.7 million shares issued; 75.5 million and 23.2 million shares outstanding as of December 31, 2014 and 2013, respectively (including 0.6 million and 0.8 million shares subject to repurchase, legally issued and outstanding as of December 31, 2014 and 2013, respectively)		
Additional paid-in capital	246,000	18,591
Accumulated other comprehensive income (loss)	(528)	10
Accumulated deficit	(131,869)	(64,454)
Treasury stock at cost; 0.5 million shares as of December 31, 2014 and 2013	(652)	(652)
Total stockholders' equity (deficit)	113,706	(46,276)
Total liabilities, redeemable convertible preferred stock, and stockholders' equity (deficit)	$205,788	$92,736

See Notes to Consolidated Financial Statements.

62

ZENDESK, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	Year Ended December 31,		
	2014	2013	2012
Revenue	$127,049	$72,045	$38,228
Cost of revenue (1)	46,047	24,531	13,253
Gross profit	81,002	47,514	24,975
Operating expenses (1):			
Research and development	36,403	15,288	14,816
Sales and marketing	77,875	37,622	22,749
General and administrative	32,869	16,437	11,558
Total operating expenses	147,147	69,347	49,123
Operating loss	(66,145)	(21,833)	(24,148)
Other expense, net	(1,533)	(517)	(96)
Loss before provision for (benefit from) income taxes	(67,678)	(22,350)	(24,244)
Provision for (benefit from) income taxes	(263)	221	121
Net loss	(67,415)	(22,571)	(24,365)
Accretion of redeemable convertible preferred stock	(18)	(49)	(50)
Deemed dividend to investors in relation to the tender offer	—	—	(8,326)
Net loss attributable to common stockholders	$(67,433)	$(22,620)	$(32,741)
Net loss per share attributable to common stockholders, basic and diluted	$(1.26)	$(1.04)	$(1.67)
Weighted-average shares used to compute net loss per share attributable to common stockholders, basic and diluted	53,571	21,674	19,629

---

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

	Year Ended December 31,		
	2014	2013	2012
Cost of revenue	$2,464	$254	$129
Research and development	10,918	635	4,117
Sales and marketing	10,680	1,210	1,313
General and administrative	8,077	2,755	4,081

See Notes to Consolidated Financial Statements.

63

ZENDESK, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(In thousands)

	Year Ended December 31,		
	2014	2013	2012
Net loss	$(67,415)	$(22,571)	$(24,365)
Other comprehensive income (loss), net of tax:			
Net change in unrealized gain (loss) on available-for-sale investments	(71)	10	—
Changes in foreign currency translation adjustment	(467)	—	(40)
Comprehensive loss	$(67,953)	$(22,561)	$(24,405)

See Notes to Consolidated Financial Statements.

ZENDESK, INC.

CONSOLIDATED STATEMENTS OF REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY (DEFICIT)

(In thousands)

	Redeemable Convertible Preferred Stock		Stockholders' Equity (Deficit)							
			Common Stock		Additional Paid-In	Treasury Stock		Accumulated Other Comprehensive Income (loss)	Accumulated	Total Stockholders'
	Shares	Amount	Shares	Amount	Capital	Shares	Amount		Deficit	Equity (Deficit)
Balances as of December 31, 2011	15,016	$26,385	21,996	$187	$1,349	(535)	$(652)	$40	$(17,518)	$(16,594)
Issuance of Series D redeemable convertible preferred stock, net of issuance costs of $115	8,582	44,885	—	—	—	—	—	—	—	—
Issuance of common stock upon exercise of stock options	—	—	718	7	207	—	—	—	—	214
Issuance of common stock upon early exercise of stock options	—	—	529	—	—	—	—	—	—	—
Vesting of early exercised stock options	—	—	—	18	705	—	—	—	—	723
Repurchase of common stock	—	—	(5)	—	—	—	—	—	—	—
Issuance of common stock warrants	—	—	—	—	182	—	—	—	—	182
	—	—	—	—	9,725	—	—	—	—	9,725

Share-based compensation										
Accretion of redeemable convertible preferred stock	—	50	—	—	(50)	—	—	—	—	(50)
Foreign currency translation adjustment	—	—	—	—	—	—	—	(40)	—	(40)
Net loss	—	—	—	—	—	—	—	—	(24,365)	(24,365)
Balances as of December 31, 2012	23,598	71,320	23,238	212	12,118	(535)	(652)	—	(41,883)	(30,205)
Issuance of common stock upon exercise of stock options	—	—	765	8	673	—	—	—	—	681
Issuance of common stock upon early exercise of stock options	—	—	164	—	—	—	—	—	—	—
Vesting of early exercised stock options	—	—	—	9	852	—	—	—	—	861
Repurchase of common stock	—	—	(457)	—	—	—	—	—	—	—
Share-based compensation	—	—	—	—	4,997	—	—	—	—	4,997
Accretion of redeemable convertible preferred stock	—	49	—	—	(49)	—	—	—	—	(49)
Unrealized gain on investment	—	—	—	—	—	—	—	10	—	10
Net loss	—	—	—	—	—	—	—	—	(22,571)	(22,571)
Balances as of December 31, 2013	23,598	71,369	23,710	229	18,591	(535)	(652)	10	(64,454)	(46,276)
Issuance of common stock upon initial	—	—	12,778	128	102,962	—	—	—	—	103,090

public offering, net of offering costs										
Accretion of redeemable convertible preferred stock	—	18	—	—	(18)	—	—	—	—	(18)
Conversion of preferred stock to common stock upon initial public offering	(23,598)	(71,387)	34,323	343	71,044	—	—	—	—	71,387
Issuance of common stock for acquisition of Zopim Technologies Ptd Ltd.	—	—	902	9	10,883	—	—	—	—	10,892
Issuance of common stock upon exercise of stock options	—	—	3,207	32	4,938	—	—	—	—	4,970
Issuance of common stock for settlement of restricted stock units (RSUs)	—	—	517	5	(5)	—	—	—	—	—
Shares withheld related to net share settlement of RSUs	—	—	(147)	(1)	(2,117)	—	—	—	—	(2,118)
Issuance of common stock upon early exercise of stock options	—	—	309	—	—	—	—	—	—	—

Vesting of early exercised stock options	—	—	—	5	1,507	—	—	—	—	1,512
Issuance of common stock in connection with employee stock purchase plans	—	—	428	4	3,267	—	—	—	—	3,271
Issuance of common stock upon exercise of warrants	—	—	111	1	(1)	—	—	—	—	—
Repurchase of common stock	—	—	(4)	—	—	—	—	—	—	—
Share-based compensation	—	—	—	—	34,615	—	—	—	—	34,615
Tax benefit from share-based award activity	—	—	—	—	334	—	—	—	—	334
Other comprehensive loss, net of income taxes	—	—	—	—	—	—	—	(538)	—	(538)
Net loss	—	—	—	—	—	—	—	—	(67,415)	(67,415)
Balances as of December 31, 2014	—	$—	76,134	$755	$246,000	(535)	$(652)	$(528)	$(131,869)	$113,706

See Notes to Consolidated Financial Statements.

ZENDESK, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Year Ended December 31,		
	2014	2013	2012
Cash flows from operating activities			
Net loss	$(67,415)	$(22,571)	$(24,365)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Depreciation and amortization	11,456	5,222	2,506
Share-based compensation	32,139	4,854	9,640
Excess tax benefit from share-based award activity	(334)	—	—
Other	337	179	123
Changes in operating assets and liabilities:			
Accounts receivable	(3,846)	(3,594)	(1,404)
Prepaid expenses and other current assets	(1,444)	(482)	(1,571)
Other assets and liabilities	1,742	303	(383)
Accounts payable	947	2,409	704
Accrued liabilities	351	1,724	401
Accrued compensation and related benefits	5,767	2,043	1,583
Deferred revenue	22,390	13,918	7,670
Net cash provided by (used in) operating activities	2,090	4,005	(5,096)
Cash flows from investing activities			
Purchases of property and equipment	(21,665)	(7,116)	(3,582)
Internal-use software costs	(8,013)	(4,661)	(3,505)
Purchases of marketable securities	(54,330)	(12,409)	—
Proceeds from maturities of marketable securities	10,450	—	—
Proceeds from sale of marketable securities	4,004	—	—
Decrease (increase) to restricted cash	153	—	(32)
Cash paid for the acquisition of Zopim, net of cash acquired	(1,896)	—	—
Net cash used in investing activities	(71,297)	(24,186)	(7,119)
Cash flows from financing activities			
Proceeds from initial public offering, net of issuance costs	103,090	—	—
Proceeds from issuance of Series D redeemable convertible preferred stock, net of issuance costs	—	—	44,885
Proceeds from exercise of employee stock options	7,229	1,793	2,125
Taxes paid related to net share settlement of equity awards	(2,117)	—	—
Proceeds from issuance of common stock from employee equity plans	4,404	—	—
Excess tax benefit from share-based award activity	334	—	—
Proceeds from issuance of debt	3,940	23,760	—
Principal payments on debt	(20,748)	—	—
Principal payments on capital lease obligations	(364)	(337)	(305)
Net cash provided by financing activities	95,768	25,216	46,705
Effect of exchange rate changes on cash and cash equivalents	(21)	2	(40)

Net increase in cash and cash equivalents	26,540	5,037	34,450
Cash and cash equivalents at the beginning of period	53,725	48,688	14,238
Cash and cash equivalents at the end of period	$80,265	$53,725	$48,688
Supplemental cash flow data:			
Cash paid for interest and income taxes	$1,056	$171	$71
Non-cash investing and financing activities:			
Deemed dividends on common stock	$—	$—	$8,326
Issuance of common stock for the acquisition of Zopim	$10,892	$—	$—
Vesting of early exercised stock options	$1,512	$860	$62
Purchases of property and equipment in accrued expenses	$374	$251	$—
Property and equipment acquired through tenant improvement allowances	$3,932	$—	$—
Issuance of warrant in connection with credit facility	$—	$—	$182
Property and equipment acquired under capital leases	$—	$—	$123
Share-based compensation capitalized in internal-use software costs	$2,476	$143	$85

See Notes to Consolidated Financial Statements.

66

ZENDESK, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Organization

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 software-as-a-service, or SaaS, customer service platform. Our platform helps organizations engage with people in new ways that foster long-term customer loyalty and satisfaction. We empower organizations to better answer customers' questions, and to solve their problems through the channels that people use every day when seeking help, such as email, chat, voice, social media and websites. Our customer service platform also helps people find answers on their own through knowledge bases and communities, capitalizing on the increasing customer preference for self-service. Our customer engagement capabilities allow organizations to proactively serve their customers, reaching out to those who may need help and soliciting feedback about their experience. The openness of our customer service platform makes it easy for organizations to integrate with their other applications. Our customer service platform consolidates the data from customer interactions and provides organizations with powerful analytics and performance benchmarking.

References to Zendesk or "we" in these notes refer to Zendesk, Inc. and its subsidiaries on a consolidated basis.

Note 2. Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles, or GAAP. The consolidated financial statements include the accounts of Zendesk, Inc. and its subsidiaries. All intercompany balances and transactions have been eliminated upon consolidation.

Initial Public Offering

In May 2014, we completed our initial public offering, or IPO, in which we issued and sold 12.8 million shares of common stock at a public offering price of $9.00 per share. We received net proceeds of $103.1 million after deducting underwriting discounts and commissions of $8.1 million and other offering expenses of $3.8 million. Upon the closing of the IPO, all shares of our then-outstanding redeemable convertible preferred stock automatically converted into an aggregate of 34.3 million shares of common stock.

Reclassification

Certain prior year amounts have been reclassified for consistency with the current year presentation. These reclassifications had no effect on the reported results of operations.

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 our common stock and share-based awards, fair value of purchased intangible assets, goodwill, unrecognized tax benefits, useful lives of purchased 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.

Segment Information

Our chief operating decision maker reviews the financial information presented on a consolidated basis for purposes of allocating resources and evaluating our financial performance. Accordingly, we have determined that we operate in a single operating segment.

Revenue Recognition

We generate substantially all of our revenue from subscription services, which are comprised of subscription fees from customer accounts on our customer service platform and, to a lesser extent, live chat software. Arrangements with customers do not provide the customer with the right to take possession of the software supporting our customer service platform or live chat software at any time, and are therefore accounted for as service contracts. Subscription service arrangements are generally non-cancelable and do not provide for refunds to customers in the event of cancellations or any other right of return. We record revenue net of sales or excise taxes.

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

- 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.

Subscription revenue is recognized on a straight-line basis over the contractual term of the arrangement beginning on the date that our service is made available to the customer. Payments received in advance of services being rendered are recorded as deferred revenue and recognized on a straight-line basis over the requisite service period.

Certain customers have arrangements that provide for a maximum number of users over the contract term, with usage measured monthly. Revenue for these arrangements is recognized ratably over the contract terms. Incremental fees are incurred when the maximum number of users is exceeded, and any incremental fees are recognized as revenue ratably over the remaining contractual term.

We derive an immaterial amount of revenue from implementation, voice, and training services, for which we recognize revenue upon completion.

Deferred Revenue

Deferred revenue consists primarily of customer billings in advance of revenue being recognized. We invoice customers for subscriptions to our customer service platform or live chat software in monthly, quarterly, or annual installments. Deferred revenue that is anticipated to be recognized during the succeeding 12-month period is recorded as current deferred revenue and the remaining portion is recorded as noncurrent deferred revenue. Deferred revenue associated with implementation, voice, and training services was immaterial as of December 31, 2014 and 2013.

Cost of Revenue

Cost of revenue consists primarily of personnel costs (including salaries, benefits, and share-based compensation) for employees associated with our platform infrastructure and our product support organizations, data center costs related to hosting our platform, depreciation and other expenses associated with our self-managed colocation data centers, amortization expense associated with capitalized internal-use software, payment processing fees, amortization expense associated with purchased intangible assets, and allocated shared costs.

Cash, Cash Equivalents, and Restricted Cash

We consider all highly liquid investments purchased with a remaining maturity of three months or less to be cash equivalents. Cash and cash equivalents are recorded at fair value and consist primarily of bank deposits and money market funds.

There was no restricted cash as of December 31, 2014 as compared to $0.2 million as of December 31, 2013. As of December 31, 2014, the certificate of deposit pledged as collateral on credit cards had been refunded.

68

Marketable Securities

Marketable securities consist of corporate bonds and auto and credit card asset backed securities. We classify marketable securities as available-for-sale at the time of purchase and reevaluate such classification as of each balance sheet date. All marketable securities are recorded at their estimated fair value. Unrealized gains and losses for available-for-sale securities are recorded in other comprehensive loss. We evaluate our investments to assess whether those with unrealized loss positions are other than temporarily impaired. Impairments are considered other than temporary if they are related to deterioration in credit risk or if it is likely we will sell the securities before the recovery of their cost basis. Realized gains and losses and declines in value determined to be other than temporary are determined based on the specific identification method and are reported in other expense, net in the consolidated statements of operations.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are recorded at the invoiced amount, net of allowance for doubtful accounts. The allowance is based upon historical loss patterns, the age of each past due invoice, and an evaluation of the potential risk of loss associated with delinquent accounts. Accounts receivable deemed uncollectable are charged against the allowance for doubtful accounts when identified.

The allowance for doubtful accounts consists of the following activity (in thousands):

	Year Ended December 31,	
	2014	2013
Allowance for doubtful accounts, beginning balance	$282	$173
Additions	843	301
Write-offs	(861)	(192)
Allowance for doubtful accounts, ending balance	$264	$282

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation. Depreciation is calculated using the straight-line method over the estimated useful lives of assets. Maintenance and repair costs are charged to expense as incurred. The estimated useful lives of our property and equipment are as follows:

Furniture and fixtures	5 years
Hosting equipment	3 years
Computer equipment and software	3 years
Leasehold improvements	Shorter of the lease term or estimated useful life

Depreciation expense of assets acquired through capital leases is included in depreciation and amortization expense in the accompanying consolidated statements of operations.

Fair Value Measurements

We measure certain financial assets at fair value using a fair value hierarchy. A financial instrument's classification within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Three levels of inputs may be used to measure fair value:

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

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

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

Our marketable securities are classified in either Level 1 or Level 2 and we have no financial assets or liabilities measured using Level 3 inputs. The fair value of our Level 1 financial assets is based on quoted market prices of the identical underlying security. The fair value of our Level 2 financial assets is based on inputs that are directly or indirectly observable in the market, including readily available pricing sources for identical underlying securities that may not be actively traded.

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. Based on borrowing rates available to us for loans with similar terms and maturities, the carrying value of borrowings approximates fair value or Level 2 within the fair value hierarchy.

Capitalized Internal-Use Software Costs

We capitalize certain development costs incurred in connection with software development for our platform and software used in operations. Costs incurred in the preliminary stages of development are expensed as incurred. Once software has reached the development stage, internal and external costs, if direct and incremental, are capitalized until the software is substantially complete and ready for its intended use. Capitalization ceases upon completion of all substantial testing. We also capitalize costs related to specific upgrades and enhancements when it is probable the expenditures will result in additional functionality. Capitalized costs are recorded as part of property and equipment. Maintenance and training costs are expensed as incurred.

Capitalized internal-use software is amortized on a straight-line basis over its estimated useful life and recorded in cost of revenue within the accompanying consolidated statements of operations. The weighted-average useful life of our capitalized internal-use software was 3.2 years as of December 31, 2014.

Business Combination

When we acquire businesses, we allocate the purchase price to the net tangible and identifiable intangible assets. Any residual purchase price is recorded as goodwill. The allocation of the purchase price requires management to make significant estimates in determining the fair values of assets acquired and liabilities assumed, especially with respect to intangible assets. These estimates can include, but are not limited to, the cash flows that an asset is expected to generate in the future, the appropriate weighted-average cost of capital, and the cost savings expected to be derived from acquiring an asset. These estimates are inherently uncertain and unpredictable.

Goodwill, Purchased Intangible Assets, and Impairment Assessment of Long-Lived Assets

Goodwill. Goodwill represents the excess purchase consideration of an acquired business over the fair value of the net tangible and identifiable intangible assets. Goodwill is evaluated for impairment annually in the third quarter, and whenever events or changes in circumstances indicate the carrying value of goodwill may not be recoverable. Triggering events that may indicate impairment include, but are not limited to, a significant adverse change in customer demand or business climate or a significant decrease in expected cash flows. No impairment charges were recorded during the year ended December 31, 2014. No goodwill was recorded prior to December 31, 2013.

Purchased Intangible Assets. Purchased intangible assets consist of identifiable intangible assets, primarily developed technology and customer relationships, resulting from our acquisition. Intangible assets are recorded at fair value on the date of acquisition and amortized over their estimated economic lives following the pattern in which the economic benefits of the assets will be consumed, generally straight-line.

Impairment of Long-Lived Assets. The carrying amounts of our long-lived assets, including property and equipment, capitalized internal-use software, and purchased intangible assets, are reviewed periodically for impairment whenever events or changes in circumstances indicate that the carrying value of these assets may not be recoverable or that the useful life is shorter than originally estimated. Recoverability of assets to be held and used is measured by comparing the carrying amount of an asset to future undiscounted net cash flows the asset is expected to generate over its remaining life. If the asset is considered to be impaired, the amount of any impairment is measured as the difference between the carrying value and the fair value of the impaired asset. If the useful life is shorter than originally estimated, we amortize the remaining carrying value over the new shorter useful life. No impairment of any long-lived assets was identified for the years ended December 31, 2014 and 2013.

Share Based Compensation

Share-based compensation expense to employees is measured based on the fair value of the awards on the grant date and recognized in our consolidated statements of operations over the period during which the employee is required to

perform services in exchange for the award (generally the vesting period of the award). We estimate the fair value of stock options granted using the Black-Scholes option valuation model. We measure the fair value of restricted stock units, or RSUs, based on the fair value of the underlying shares on the date of grant. Compensation expense for awards with only service conditions is recognized over the vesting period of the applicable award using the straight-line method.

70

All RSUs and certain options granted to employees prior to the IPO vest upon the satisfaction of both a service condition and a performance condition. These RSUs and stock options with both a service condition and performance condition are collectively referred to as “Performance Awards” in the following discussion. The service condition for substantially all of these awards is satisfied over four years. The performance condition was satisfied upon the occurrence of a qualifying liquidity event which occurred upon the effectiveness of the registration statement related to our IPO. No share-based compensation expense was recognized for the Performance Awards prior to the IPO as the performance condition had not been deemed probable to have been met. Upon the satisfaction of the performance condition, we recognized a cumulative share-based compensation expense for the portion of the Performance Awards that had met the service condition. For the year ended December 31, 2014, share-based compensation expense related to the Performance Awards recognized was $12.7 million, using the accelerated attribution method. The remaining unrecognized share-based compensation expense related to the Performance Awards will be recorded over the remaining requisite service period using the accelerated attribution method, net of estimated forfeitures.

As of December 31 2014, we had a total of $74.5 million in future period share-based compensation expense related to all equity awards, net of estimated forfeitures, to be recognized over a weighted average period of 3.5 years.

Advertising Expense

Advertising is expensed as incurred. For the years ended December 31, 2014, 2013, and 2012, advertising expense was $12.7 million, $6.5 million, and $3.5 million, respectively.

Income Taxes

We record income taxes using the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in our consolidated financial statements or tax returns. Deferred tax assets and liabilities are measured using the tax rates that are expected to apply to taxable income for the years in which those tax assets and liabilities are expected to be realized or settled. Valuation allowances are provided when necessary to reduce deferred tax assets to the amount expected to be realized.

We recognize tax benefits from uncertain tax positions if it is more likely than not that the tax position will be sustained on examination by the taxing authorities based on the technical merits of the position. Although we believe that we have adequately reserved for our uncertain tax positions, we can provide no assurance that the final tax outcome of these matters will not be materially different. We make adjustments to these reserves when facts and circumstances change, such as the closing of a tax audit or the refinement of an estimate. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will affect the provision for income taxes in the period in which such determination is made and could have a material impact on our financial condition and results of operations.

We have elected to record interest accrued and penalties related to unrecognized tax benefits in the financial statements as a component of provision for income taxes.

Foreign Currency

The functional currency of our foreign subsidiaries, with the exception of our Singapore subsidiary, is the U.S. dollar. Accordingly, monetary balance sheet accounts are remeasured using exchange rates in effect at the balance sheet dates and non-monetary items are remeasured at historical exchange rates. Expenses are generally remeasured at the average exchange rates for the period. Foreign currency remeasurement and transaction gains and losses are included in other expense, net on the statements of operations and were not material for the periods presented. The functional currency of our Singapore subsidiary is the Singapore dollar. Assets and liabilities are translated into U.S. dollars at exchange rates in effect at the balance sheet dates. Revenue and expenses are translated at the average exchange rates for the period. Amounts classified in stockholders’ equity (deficit) are translated at historical exchange rates.

Concentrations of Risk

Financial instruments potentially exposing us to concentrations of credit risk consist primarily of cash and cash equivalents, restricted cash, marketable securities and accounts receivable. We place our cash and cash equivalents with high-credit-quality financial institutions. However, we maintain balances in excess of the FDIC insurance limits. We do not require our customers to provide collateral to support accounts receivable and maintain an allowance for doubtful accounts receivable balances.

At December 31, 2014 and 2013, there were no customers that represented more than 10% of the accounts receivable balance. There were no customers that individually exceeded 10% of our revenue in any of the periods presented.

Recently Issued Accounting Standards

In February 2013, the Financial Accounting Statements Board, or FASB, issued Accounting Standards Update No. 2013-02 "Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income," which requires an entity to disaggregate the total change of each component of other comprehensive income either on the face of the statement of operations or as a separate disclosure in the notes. The guidance became effective for reporting periods beginning after December 15, 2012 and is applied prospectively. We adopted this standard for the year ended December 31, 2013, and the adoption did not have any impact on our financial position, results of operations, or cash flows, as the amounts reclassified out of accumulated other comprehensive loss are not significant.

In July 2013, the FASB issued Accounting Standards Update No. 2013-11 "Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists," or ASU 2013-11, which provides guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss, or NOL, carryforward, a similar tax loss, or a tax credit carryforward exists. ASU 2013-11 supports the approach for companies to present an unrecognized tax benefit as a reduction of a deferred tax asset for a NOL or tax credit carryforward whenever the NOL or tax credit carryforward would be available to reduce the additional taxable income or tax due if the tax position is disallowed. This approach requires companies to assess whether to net the unrecognized tax benefit with a deferred tax asset as of the reporting date. We adopted this standard for the year ended December 31, 2014, and the adoption did not have a material effect on our financial position, results of operations, or cash flows.

On May 28, 2014, the Financial Accounting Statements Board, or FASB, issued ASU 2014-09 regarding ASC Topic 606 "Revenue from Contracts with Customers." This ASU provides principles for recognizing revenue for the transfer of promised goods or services to customers with the consideration to which the entity expects to be entitled in exchange for those goods or services. This ASU will be effective for our fiscal year beginning January 1, 2017. Early adoption is not permitted. We are currently evaluating the accounting, transition, and disclosure requirements of the standard and cannot currently estimate the financial statement impact of adoption.

Note 3. Acquisition of Zopim Technologies

On March 21, 2014, we completed the acquisition of Zopim Technologies Pte Ltd., or Zopim, a software development company that provides a SaaS live chat service. During the three months ended December 31, 2014, we finalized our purchase accounting after adjustments were made to the preliminary purchase price allocation. The total adjusted acquisition date fair value of consideration transferred was $15.8 million ($4.9 million of cash and $10.9 million of our common stock), which included $1.1 million of cash and $2.4 million of common stock consideration held back between 12 and 18 months as partial security for standard indemnification obligations. The total adjusted purchase price was allocated to assets acquired and liabilities assumed as set forth below (in thousands). The excess of the purchase price over the net assets acquired was recorded as goodwill. Goodwill generated from the acquisition is attributable to expected synergies from future growth and potential future monetization opportunities, and is not deductible for tax purpose.

Net tangible liabilities assumed	$(385	)
Intangible assets	6,560	
Goodwill	9,594	

Total purchase price	$15,769

In connection with the acquisition, we also established a retention plan pursuant to which we issued RSUs for 0.9 million shares of our common stock, which vest in three annual installments from the date of acquisition. In addition, we agreed to pay cash in an aggregate amount of $3.0 million in two annual installments from the date of acquisition to Zopim employees in connection with their continued employment, which is recorded as compensation expense over the associated service periods of such employees.

Pro forma revenue and results of operations have not been presented because the historical results of Zopim were not material to our consolidated financial statements in any period presented.

Note 4. Fair Value Measurements

The following tables present information about our financial assets measured at fair value on a recurring basis as of December 31, 2014 and 2013 based on the three-tier fair value hierarchy (in thousands):

	Fair Value Measurement at December 31, 2014		
	Level 1	Level 2	Total
Description			
Corporate bonds	$—	40,345	$40,345
Money market funds	21,382	—	21,382
Asset-backed securities	—	5,080	5,080
Commercial paper	—	3,993	3,993
U.S. treasury securities	—	1,991	1,991
Total	$21,382	$51,409	$72,791
Included in cash and cash equivalents			$21,382
Included in marketable securities			$51,409

	Fair Value Measurement at December 31, 2013		
	Level 1	Level 2	Total
Description			
Corporate bonds	$—	$12,114	$12,114
Money market funds	10,836	—	10,836
Total	$10,836	$12,114	$22,950
Included in cash and cash equivalents			$10,836
Included in marketable securities			$12,114

There were no transfers between fair value measurement levels during the years ended December 31, 2014 or 2013.

Gross unrealized gains or losses for cash equivalent and marketable securities as of December 31, 2014 and 2013 were not material. As of December 31, 2014 and 2013, there were no securities that were in an unrealized loss position for more than twelve months.

The following table classifies our marketable securities by contractual maturities as of December 31, 2014 and 2013 (in thousands):

	December 31, 2014	December 31, 2013
Due in one year	$ 42,204	$ 9,889
Due in one to five years	9,205	2,225
Total	$ 51,409	$ 12,114

Note 5. Property and Equipment

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

	December 31, 2014	December 31, 2013
Capitalized internal-use software	$ 18,541	$ 11,104
Furniture and fixtures	4,524	1,383
Hosting equipment	14,085	7,931
Computer equipment and software	4,310	1,680
Leasehold improvements	15,144	1,717
Construction in progress	3,546	341
Total	60,150	24,156
Less accumulated depreciation and amortization	(18,255)	(8,725)
Property and equipment, net	$ 41,895	$ 15,431

73

Depreciation expense was $6.1 million, $2.9 million, and $1.1 million for the years ended December 31, 2014, 2013, and 2012, respectively. We capitalized $10.5 million, $4.8 million, and $3.6 million in costs associated with internal-use software during the years ended December 31, 2014, 2013, and 2012, respectively. Included in the capitalized internal-use software costs are $2.5 million, $0.1 million, and $0.1 million in share-based compensation costs for the years ended December 31, 2014, 2013, and 2012, respectively. Amortization expense of capitalized internal-use software totaled $3.8 million, $2.3 million, and $1.4 million during the years ended December 31, 2014, 2013, and 2012, respectively. The carrying value of capitalized internal-use software at December 31, 2014 and 2013 was $13.6 million and $6.8 million, respectively, including $3.5 million and $0.3 million in construction in progress, respectively.

Note 6. Goodwill and Purchased Intangibles Assets

The changes in the carrying amount of goodwill for the year ended December 31, 2014 are as follows (in thousands):

Balance as of December 31, 2013	$—
Goodwill acquired	9,373
Goodwill adjustments	221
Foreign currency translation adjustments	(354)
Balance as of December 31, 2014	$9,240

Purchased intangible assets related to the Zopim acquisition subject to amortization as of December 31, 2014 consist of the following (in thousands). No purchased intangible assets were recorded as of December 31, 2013.

	Cost	Accumulated Amortization	Foreign Currency Translation Adjustments	Net	Remaining Useful Life (In years)
Developed technology	$5,200	$ (1,118)	$ (191)	$3,891	2.7
Customer relationships	1,300	(244)	(48)	1,008	3.2
Trade name	60	(45)	(2)	13	0.2
	$6,560	$ (1,407)	$ (241)	$4,912	

Amortization expense of purchased intangible assets related to the Zopim acquisition for the year ended December 31, 2014 was $1.4 million. No amortization expense was recorded for the year ended December 31, 2013.

Estimated future amortization expense as of December 31, 2014 is as follows (in thousands):

2015	$1,757
2016	1,744
2017	1,342

2018	69
	$4,912

Note 7. Credit Facility

We have a credit facility with Silicon Valley Bank consisting of a $20.0 million revolving line of credit and a $10.0 million equipment line of credit. As of December 31, 2013, outstanding balance under the revolving line of credit was $20.0 million. In June 2014 we repaid all outstanding principal and accrued interest under the revolving line of credit and as of December 31, 2014 there was no balance outstanding. As of December 31, 2014 and 2013, outstanding balance under the equipment line of credit was $7.0 million and $3.8 million, respectively.

Prior to our IPO, borrowings on the revolving line of credit bore interest at the Prime Rate plus 2.0% per annum. Upon the consummation of the IPO, the interest rate was reduced to the Prime Rate. Borrowings on the revolving line of credit are subject to a borrowing base limit determined monthly based on our recurring revenue metrics from previous months and the ratio of certain current assets to current liabilities as of the previous month end. To the extent we borrow funds on the revolving line of credit, we are entitled to make interest-only payments until January 1, 2016, when the outstanding balance is due in full.

74

Borrowings on the equipment line of credit bear interest of 2.5% per annum. For each equipment advance, we were entitled to make interest-only payments until September 14, 2014, when the last draw against the equipment line of credit could be made. The outstanding balance as of September 14, 2014 is payable in 30 equal monthly installments, with the last payment due on March 14, 2017. We are also required to make a final payment fee of $0.3 million on March 14, 2017.

The credit facility is collateralized by substantially all of our assets, excluding our intellectual property. Our domestic subsidiary is a guarantor of the credit facility and we have pledged up to 65% of the equity in our international subsidiaries as collateral. The credit facility also imposes various covenants on us, including the delivery of financial and other information, the maintenance of our primary operating and securities accounts with the lender, the maintenance of minimum revenue targets and an agreed ratio of certain current assets to current liabilities, as well as limitations on dispositions, changes in business or management, certain mergers or consolidations, dividends and other corporate activities. As of December 31, 2014 and 2013, we were in compliance with all of the covenants contained in the credit facility.

Contractual future principal repayments in relation to the credit facility are as follows for the year ending December 31 (in thousands):

2015	$3,041
2016	3,118
2017	793
	$6,952

In June 2012, in connection with the credit facility, we issued a non-refundable, fully earned warrant to Silicon Valley Bank to purchase 125,000 shares of common stock at $1.92 per share with an expiration date of June 2019. The fair value of the warrant on issuance is being accreted to interest expense using the effective interest rate method over the life of the credit facility. This warrant was exercised in the three months ended June 30, 2014.

Note 8. Commitments and Contingencies

Leases

We lease office space under noncancelable operating leases with various expiration dates. Certain of the office space lease agreements contain rent holidays or rent escalation provisions. Rent holiday and rent escalation provisions are considered in determining the straight-line expense to be recorded over the lease term. The lease term begins on the date of initial possession of the leased property for purposes of recognizing lease expense on a straight-line basis over the term of the lease. In 2013, we renewed the lease of our office in San Francisco through October 2019, with an option to renew for an additional 7 years and 8 months. We also entered into a lease for additional office space in San Francisco with an 8-year term, renewable for an additional period of 5 years. For the years ended December 31, 2014, 2013, and 2012, rent expense was $6.8 million, $2.3 million, and $1.6 million, respectively.

We lease computer equipment from various parties under capital lease agreements that expire through March 2015. The total outstanding balance financed under capital leases was immaterial at December 31, 2014 and $0.4 million at December 31, 2013. Accumulated depreciation on the leased assets was $1.0 million and $0.7 million at December 31, 2014 and 2013, respectively. Depreciation of assets recorded under capital leases is included in depreciation expense.

As of December 31, 2014, the future minimum lease payments by year under noncancelable leases are as follows for the year ending December 31 (in thousands):

2015	$7,025
2016	7,067
2017	6,935
2018	6,936
2019	6,672
Thereafter	12,707
Total minimum lease payments	$47,342

75

Letters of Credit

As of December 31, 2014 and 2013, we had a total of $3.7 million and $3.8 million, respectively, in letters of credit outstanding primarily related to our leased office space in San Francisco. The letters of credit are collateralized by substantially all of our assets, excluding our intellectual property. These letters of credit renew annually and mature at various dates through October 31, 2022.

Litigation and Loss Contingencies

We accrue estimates for resolution of legal and other contingencies when losses are probable and estimable. From time to time, we may become a party to litigation and subject to claims incident to the ordinary course of business, including intellectual property claims, labor and employment claims, and threatened claims, breach of contract claims, tax, and other matters. We currently have no material pending litigation.

We are not currently aware of any litigation matters or loss contingencies that would be expected to have a material adverse effect on our business, consolidated financial position, results of operations, comprehensive loss, or cash flows.

Indemnifications

In the ordinary course of business, we enter into contractual arrangements under which we agree to provide indemnification of varying scope and terms to business partners and other parties with respect to certain matters, including, but not limited to, losses arising out of the breach of such agreements, intellectual property infringement claims made by third parties, and other liabilities relating to or arising from our customer service platform, live chat software, or our acts or omissions. In these circumstances, payment may be conditional on the other party making a claim pursuant to the procedures specified in the particular contract. Further, our obligations under these agreements may be limited in terms of time and/or amount, and in some instances, we may have recourse against third parties for certain payments. In addition, we have indemnification agreements with our directors and executive officers that require us, among other things, to indemnify them against certain liabilities that may arise by reason of their status or service as directors or officers. The terms of such obligations may vary. To date, we have not incurred any material costs, and we have not accrued any liabilities in the accompanying consolidated financial statements, as a result of these obligations.

We have entered into service-level agreements with certain customers warranting defined levels of uptime reliability and performance and permitting those customers to receive credits for future services in the event that we fail to meet those levels. To date, we have not experienced any significant failures to meet the defined levels of reliability and performance warranted by those agreements and, as a result, we have not accrued any liabilities related to these agreements in the accompanying consolidated financial statements.

Note 9. Common Stock and Stockholders’ Equity (Deficit)

Convertible Preferred Stock

Upon the completion of the IPO, all outstanding convertible preferred stock was converted into 34.3 million shares of common stock.

Reverse Stock Split

In April 2014, our board of directors and stockholders approved a one-for-two reverse stock split of our common stock. All share and per share information throughout the consolidated financial statements and notes to the consolidated financial statements have been retroactively adjusted to reflect this reverse stock split.

Common Stock Authorized

At December 31, 2013, there were 80.0 million and 30.0 million shares authorized for Series A and Series B common stock, respectively, and there were 9.9 million and 13.3 million shares outstanding of Series A and Series B common stock, respectively, of which 0.8 million shares of Series B common stock were unvested resulting from employees exercising stock options prior to vesting. Upon the completion of our IPO, each share of Series B common stock was converted into Series A common stock on a one-for-one basis, and the Series A common stock was redesignated as common stock. In addition, we increased the amount of common stock authorized for issuance to 400.0 million common shares with a par value of $0.01 per share.

Employee Equity Plans

Employee Stock Purchase Plan

Our board of directors adopted the Employee Stock Purchase Plan, or ESPP, in February 2014, which became effective in May 2014 upon the effectiveness of the registration statement related to our IPO. The ESPP initially reserved and authorized the issuance of up to 3.6 million shares of common stock. The ESPP provides that the number of shares reserved and available for issuance under the plan automatically increases each January, beginning on January 1, 2015, by the lesser of 1.5 million shares, 1% of the number of shares issued and outstanding on the immediately preceding December 31, or such lesser number of shares as determined by our compensation committee.

Under the ESPP, eligible employees are granted options to purchase shares of our common stock through payroll deductions. The ESPP provides for eighteen-month offering periods, which include three six-month purchase periods. At the end of each purchase period, employees are able to purchase shares at 85% of the lower of the fair market value of our common stock at the beginning of an offering period or the fair market value of our common stock at the end of the purchase period. We commenced our first purchase period under the ESPP on May 15, 2014. For the year ended December 31, 2014, 0.4 million shares of common stock were purchased under the ESPP at $7.65 per share, resulting in cash proceeds of $3.3 million. As of December 31, 2014, 3.2 million shares of common stock were available for issuance under the ESPP.

Stock Option and Grant Plan

Our board of directors adopted the 2009 Stock Option and Grant Plan, or the 2009 Plan, in July 2009. The 2009 Plan was terminated in connection with our IPO, and accordingly, no shares are available for issuance under this plan. The 2009 Plan continues to govern outstanding awards granted thereunder.

Our board of directors adopted the 2014 Stock Option and Incentive Plan, or the 2014 Plan, in February 2014, which became effective in May 2014 upon the effectiveness of the registration statement related to our IPO. The 2014 Plan serves as the successor to our 2009 Plan. The 2014 Plan initially reserved and authorized the issuance of 7.5 million shares of our common stock. Additionally, shares not issued or subject to outstanding grants under the 2009 Plan rolled into the 2014 Plan, resulting in a total of 8.3 million available shares under the 2014 Plan as of the effective date. The 2014 Plan provides that the number of shares reserved and available for issuance under the plan automatically increases each January 1, beginning on January 1, 2015, by 5% of the outstanding number of shares of our common stock on the immediately preceding December 31, or such lesser number of shares as determined by our compensation committee.

A summary of our stock option and RSU activity for the year ended December 31, 2014 is as follows (in thousands, except per share information):

		Options Outstanding				RSUs Outstanding	
	Shares Available for Grant	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (In years)	Aggregate Intrinsic Value	Outstanding RSUs	Weighted Average Grant Date Fair Value
Outstanding — January 1, 2014	1,854	10,134	$ 2.82	8.15	$ 50,185	811	$ 6.76
Increase in authorized shares	13,750						

Stock options granted	(6,308)	6,308	11.40				
RSUs granted	(3,030)					3,030	14.44
Stock options exercised		(3,516)	2.03				
RSUs vested						(370)	9.56
Unvested shares repurchased	4						
Stock options forfeited or canceled	883	(883)	4.96				
RSUs forfeited or cancelled	407					(407)	9.31
Outstanding — December 31, 2014	7,560	12,043	$ 7.39	8.29	$ 204,467	3,064	$ 13.69
Options vested and expected to vest as of December 31, 2014		10,742	$ 7.07	8.21	$ 185,866		
Options vested and exercisable as of December 31, 2014		4,293	$ 3.87	7.34	$ 88,025		

The total intrinsic value of stock options exercised during the year ended December 31, 2014, 2013, 2012 was $66.2 million, $4.6 million, and $1.8 million, respectively. Aggregate intrinsic value for options exercised represents the difference between the exercise price and the market value on the date of exercise. The weighted-average grant date fair value of stock options granted during the years ended December 31, 2014, 2013, and 2012 was $7.22, $1.62, and $0.56, respectively.

Aggregate intrinsic value for options outstanding represents the difference between the closing stock price of our common stock and the exercise price of outstanding, in-the-money options. Zendesk's closing stock price as reported on the New York Stock Exchange as of December 31, 2014 was $24.37.

Share-Based Compensation Expense

All share-based awards to employees and members of our board of directors are measured based on the grant date fair value of the awards and recognized in the consolidated statements of operations over the period during which the employee is required to perform services in exchange for the award (generally the vesting period of the award). We record share-based compensation expense for service-based equity awards using the straight-line attribution method. We record share-based compensation expense for performance-based equity awards using the accelerated attribution method.

We estimate the fair value of stock options granted using the Black-Scholes option valuation model, which requires assumptions, including the fair value of our underlying common stock, expected term, expected volatility, risk-free interest rate and dividend yield of our common stock. These estimates involve inherent uncertainties and the application of management's judgment. If factors change and different assumptions are used, our share-based compensation expense could be materially different in the future.

These assumptions are estimated as follows:

- Fair Value of Common Stock. Prior to our IPO in May 2014, our board of directors, with input from management, exercised significant judgment and considered numerous objective and subjective factors to determine the fair value of our common stock as of the date of each option grant. These factors included, but were not limited to: (i) contemporaneous valuations performed by unrelated third-party specialists, (ii) rights, preferences, and privileges of our redeemable convertible preferred stock relative to those of our common stock, (iii) actual operating and financial performance, (iv) relevant precedent transactions involving our capital stock, (v) likelihood of achieving a liquidity event, such as an initial public offering or a sale of our company given prevailing market conditions and the nature and history of our business, (vi) market multiples of comparable companies in our industry, (vii) stage of development, (viii) industry information such as market size and growth, (ix) illiquidity of share-based awards involving securities in a private company, and (x) macroeconomic conditions.

Since our IPO, we have used the market closing price for our common stock as reported on the New York Stock Exchange.

- Expected Term. We determine the expected term based on the average period the stock options are expected to remain outstanding generally calculated as the midpoint of the stock options vesting term and contractual expiration period, as we do not have sufficient historical information to develop reasonable expectations about future exercise patterns and post-vesting employment termination behavior.
- Expected Volatility. We determine the price volatility factor based on the historical volatility of publicly traded industry peers. To determine our peer group of companies, we consider public companies in the technology industry and select those that are similar to us in size, stage of life cycle, and financial leverage. We do not rely on implied volatilities of traded options in our industry peers' common stock because the volume of activity is relatively low. We intend to continue to consistently apply this methodology using the same or similar public companies until a sufficient amount of historical information regarding the volatility of our own common stock price becomes available, or unless circumstances change such that the identified companies are no longer similar to us, in which

case, more suitable companies whose share prices are publicly available would be utilized in the calculation.

- Risk-Free Interest Rate. We base the risk-free interest rate used in the Black-Scholes valuation model on the yield available on U.S. Treasury zero-coupon issues with an equivalent remaining term of the stock options for each stock option group
- Dividend Yield. We have not paid and do not anticipate paying any cash dividends in the foreseeable future and, therefore, use an expected dividend yield of zero.

78

The assumptions used to estimate the fair value of stock options granted to employees are as follows:

	Year Ended December 31,		
	2014	2013	2012
Expected volatility	54% - 56%	50% - 63%	57% - 59%
Dividend rate	0%	0%	0%
Risk-free interest rate	1.75% - 2.02%	0.63% - 2.02%	0.68% - 1.47%
Expected term (in years)	6.02 - 6.50	4.47 - 6.27	5.28 - 6.27

The assumptions used to estimate the fair value of ESPP awards are as follows:

	Year Ended December 31, 2014
Expected volatility	45% - 49%
Dividend rate	0%
Risk-free interest rate	0.05% - 0.35%
Expected term (in years)	0.50 - 1.5

In addition to the assumptions used in the Black-Scholes option valuation model, we must also estimate a forfeiture rate to calculate the share-based compensation expense for our awards. Our forfeiture rate is based on an analysis of our actual forfeitures. We will continue to evaluate the appropriateness of the forfeiture rate based on actual forfeiture experience, analysis of employee turnover, and other factors. Changes in the estimated forfeiture rate can have a significant impact on our share-based compensation expense as the cumulative effect of adjusting the rate is recognized in the period the forfeiture estimate is changed. If a revised forfeiture rate is higher than the previously estimated forfeiture rate, an adjustment is made that will result in a decrease to the share-based compensation expense recognized in our financial statements. If a revised forfeiture rate is lower than the previously estimated forfeiture rate, an adjustment is made that will result in an increase to the share-based compensation expense recognized in our financial statements.

We will continue to use judgment in evaluating the expected volatility, expected term, and forfeiture rate utilized in our share-based compensation expense calculations on a prospective basis. As we continue to accumulate additional data related to our common stock, we may refine our estimates of expected volatility, expected term, and forfeiture rates, which could materially impact our future share-based compensation expense.

In the years ended December 31, 2014 and 2013 we recorded $4.3 million and $1.7 million share-based compensation expense related to the accelerated vesting of certain stock options resulting from employee terminations, respectively. No such expense was recorded in the year ended December 31, 2012.

In September 2012, in connection with our sale of the Series D redeemable convertible preferred stock, the purchasers of the Series D redeemable convertible preferred stock conducted a tender offer to acquire approximately 8.0 million shares of common stock from employees, former employees, and other existing investors. In connection with the tender offer, we waived any rights of first refusal or other transfer restrictions applicable to such shares. The shares were repurchased from the stockholders at a purchase price of $9.62 per share. As a result of this transaction, we recorded a total of $8.6 million in share-based compensation expense in the year ended December 31, 2012 for the difference between the price paid for shares held by our employees and former employee stockholders and the estimated fair market value on the date of the transaction. Of the total share-based compensation expense, we recorded $20,000, $3.9 million, $1.0 million, and $3.7 million in cost of revenue, research and development, sales and marketing, and general and administrative expenses, respectively.

In connection with the tender offer, we recorded $8.3 million in deemed dividends, within additional paid-in capital, for the difference between the price paid for shares held by stockholders that were not employees or former employees and the estimated fair market value on the date of the transaction.

79

Early Exercise of Stock Options and Purchase of Unvested Stock Awards

Common stock purchased pursuant to an early exercise of stock options or unvested stock awards is not deemed to be outstanding for financial reporting purposes until those shares vest. Therefore, cash received in exchange for unvested shares is recorded as a liability and is transferred into common stock and additional paid-in capital as the shares vest. Upon termination of service, we may, at our discretion, repurchase unvested shares acquired through early exercise of stock options or purchase of unvested stock awards at a price equal to the price per share paid upon the exercise of such options or the purchase of such unvested stock awards. As of December 31, 2014 and 2013 there were 0.6 million and 0.8 million shares outstanding as a result of early exercise of stock options and purchase of unvested stock awards by our employees and directors that were classified as accrued liabilities for an aggregated amount of $2.1 million and $1.4 million, respectively.

Treasury Stock

We repurchased 0.5 million shares of common stock in the year ended December 31, 2011 and recorded the repurchased shares as treasury shares in the stockholders’ equity (deficit) section of the balance sheet at cost.

Note 10. Net Loss Per Share

We compute net loss per share of common stock in conformity with the two-class method required for participating securities. We consider all series of the redeemable convertible preferred stock to be participating securities as the holders of the preferred stock are entitled to receive a non-cumulative dividend on a pari passu basis in the event that a dividend is paid on common stock. We also consider shares of common stock issued upon the early exercise of stock awards subject to repurchase to be participating securities, because holders of such shares have non-forfeitable dividend rights in the event a dividend is paid on common stock. The holders of all series of the redeemable convertible preferred stock and the holders of shares of common stock acquired upon early exercise of stock options do not have a contractual obligation to share in our losses. As such, our net losses for the years ended December 31, 2014, 2013 and 2012 were not allocated to these participating securities. Upon the closing of the IPO in May 2014, all shares of our then-outstanding redeemable convertible preferred stock automatically converted into our common stock.

Basic net loss per share attributable to common stockholders is computed by dividing the net loss attributable to common stockholders by the weighted-average number of shares of common stock outstanding during the period, less the weighted-average unvested common stock subject to repurchase. Diluted net loss per share is computed by giving effect to all potential shares of common stock, including common stock issuable upon conversion of the redeemable convertible preferred stock, outstanding share-based awards, and outstanding warrant, to the extent dilutive. Basic and diluted net loss per share was the same for each period presented as the inclusion of all potential common stock outstanding would have been anti-dilutive.

The following table presents the calculation of basic and diluted net loss per share for the periods presented (in thousands, except per share data):

	Year Ended December 31,

	2014	2013		2012	
		Class A	Class B	Class A	Class B
Net loss	$(67,415)	$(10,290)	$(12,281)	$(12,104)	$(12,261)
Less: Accretion of redeemable convertible preferred stock	(18)	(22)	(27)	(25)	(25)
Less: Deemed dividend to investors in relation to the tender offer	—	—	—	(4,136)	(4,190)
Net loss attributable to common stockholders	$(67,433)	$(10,312)	$(12,308)	$(16,265)	$(16,476)
Basic shares:					
Weighted-average common shares outstanding	54,383	9,881	12,964	9,881	12,153
Less: Weighted-average common shares subject to repurchase	(812)	—	(1,171)	(130)	(2,275)
Weighted-average common shares used to compute basic net loss per share	53,571	9,881	11,793	9,751	9,878
Diluted shares:					
Weighted-average common shares used to compute diluted net loss per share	53,571	9,881	11,793	9,751	9,878
Net loss per share attributable to common stockholders:					
Basic and diluted	$(1.26)	$(1.04)	$(1.04)	$(1.67)	$(1.67)

80

The anti-dilutive securities excluded from the shares used to calculate the diluted net loss per common stock are as follows (in thousands):

	As of December 31,		
	2014	2013	2012
Redeemable convertible preferred stock	—	34,323	34,323
Shares subject to outstanding common stock options	12,043	10,134	7,781
Shares subject to common stock warrants	—	125	125
Restricted stock units	3,064	811	—
	15,107	45,393	42,229

Note 11. Income Taxes

The components of loss before provision for income taxes are as follows (in thousands):

	Year Ended December 31,		
	2014	2013	2012
U.S.	$(66,755)	$(23,117)	$(24,739)
Foreign	(923)	767	495
Total	$(67,678)	$(22,350)	$(24,244)

The income tax provision is composed of the following (in thousands):

	Year Ended December 31,		
	2014	2013	2012
Current tax provision:			
Federal	$ 2	$ —	$ —
State	1	37	2
Foreign	567	189	126
	570	226	128
Deferred tax provision:			
Federal	—	—	—
State	—	—	—
Foreign	(833)	(5)	(7)
Total provision for (benefit from) income taxes	$ (263)	$ 221	$ 121

Significant components of deferred tax assets are as follows (in thousands):

	As of December 31,	
	2014	2013
Deferred tax assets:		
Tax credit carryforward	$197	$15
Net operating loss carryforward	33,878	19,278
Share-based compensation	5,311	771
Accrued liabilities and reserves	3,710	1,316
Other	600	677
Total deferred tax assets	43,696	22,057
Less: valuation allowance	(39,496)	(19,837)
Deferred tax assets, net of valuation allowance	4,200	2,220
Deferred tax liabilities:		
Depreciation and amortization	(4,597)	(2,207)
Net deferred tax assets (liabilities)	$(397)	$13

81

The following is a reconciliation of the statutory federal income tax rate and the effective tax rates:

	Year Ended December 31,		
	2014	2013	2012
Tax at federal statutory rate	34.0 %	34.0 %	34.0 %
State tax provision, net of federal benefit	—	(0.2)	—
Share-based compensation	(5.5)	(4.4)	(11.1)
Valuation allowance	(27.9)	(30.4)	(23.3)
Other	(0.2)	—	(0.1)
Effective tax rate	0.4 %	(1.0 %)	(0.5 %)

We have not provided U.S. income taxes and foreign withholding taxes on the undistributed earnings of foreign subsidiaries as of December 31, 2014 because we intend to permanently reinvest such earnings outside of the U.S. If these foreign earnings were to be repatriated in the future, the related U.S. tax liability may be reduced by any foreign income taxes previously paid on these earnings. As of December 31, 2014, the cumulative amount of earnings upon which U.S. income taxes have not been provided is approximately $2.4 million. Determination of the amount of unrecognized deferred tax liability related to these earnings is not practicable.

As of December 31, 2014, we had net operating loss carryforwards of approximately $133.0 million for federal income taxes and $47.5 million for state income taxes. If not utilized, these carryforwards will begin to expire in 2029 for federal purposes and 2031 for state purposes.

We account for income taxes under an asset and liability approach. Deferred income taxes reflect the impact of temporary differences between assets and liabilities recognized for financial reporting purposes and such amounts recognized for income tax reporting purposes, net operating loss carryforwards, and other tax credits measured by applying currently enacted tax laws.

As of December 31, 2014, we had research and development credit carryforwards of approximately, $2.5 million and $2.7 million for federal and state income taxes, respectively. If not utilized, the federal carryforwards will begin to expire in 2029. The state tax credit can be carried forward indefinitely.

A share option exercise may result in a tax deduction prior to the actual recognition of the related excess tax benefit because we have a net operating loss carryforward. Our net operating losses include $40.9 million of excess stock option benefits that will be creditable to additional paid in capital when realized.

Internal Revenue Code Section 382 limits the use of net operating loss and tax credit carryforwards in certain situations where changes occur in the stock ownership of a company. In the event that we had a change of ownership, utilization of the net operating loss and tax credit carryforwards may be restricted.

A reconciliation of the beginning and ending amount of unrecognized tax benefits (excluding interest and penalties) is as follows (in thousands):

Balance at December 31, 2012	$1,939
Additions for tax positions related to the prior year	—
Additions for tax positions related to the current year	1,978
Lapse of statutes of limitations	—
Balance at December 31, 2013	3,917
Additions for tax positions related to the prior year	(32)

Additions for tax positions related to the current year	2,070
Lapse of statutes of limitations	—
Balance at December 31, 2014	$5,955

As of December 31, 2014, we had $0.3 million of interest and penalties related to the uncertain tax positions. We have elected to record interest and penalties in the financial statements as a component of income taxes. Included in the balance of unrecognized tax benefits at December 31, 2014 and 2013 are potential benefits of $0.9 million and $0.5 million, respectively, which if recognized, would affect the effective tax rate.

We are currently unaware of any uncertain tax positions that could result in significant additional payments, accruals, or other material deviation in this estimate over the next 12 months.

82

Our 2009-2013 tax years remain subject to examination by the taxing authorities for U.S. federal, state, and foreign tax purposes.

Note 12. Geographic Information

Revenue

The following table presents our revenue by geographic areas as determined based on the billing address of our customers (in thousands):

	Year Ended December 31,		
	2014	2013	2012
United States	$72,217	$42,415	$22,445
EMEA	35,856	19,125	10,257
Other	18,976	10,505	5,526
Total	$127,049	$72,045	$38,228

Long-Lived Assets

The following table presents our long-lived assets by geographic areas (in thousands):

	As of December 31, 2014	As of December 31, 2013
United States	$ 22,817	$ 6,466
EMEA	4,373	2,054
Other	1,096	135
Total	$ 28,286	$ 8,655

The carrying value of capitalized internal-use software is excluded from the balance of long-lived assets presented in the table above.

Note 13. Retirement Plans

We have a 401(k) retirement and savings plan made available to all United States employees. The 401(k) plan allows each participant to contribute up to an amount not to exceed an annual statutory maximum. We may, at our discretion, make matching contributions to the 401(k) plan. We are responsible for the administrative costs of the 401(k) plan. We have not made any contributions to the 401(k) plan since inception.

Note 14. Subsequent Events

In January 2015, we changed the time-off policy for U.S. employees. Under the new policy, salaried employees no longer accrue paid time off and a one-time payment of $2.4 million was made in January 2015 to U.S. salaried employees for the amount accrued as of such date.

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.

None.

Item 9A. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness 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 Annual Report on Form 10-K. Based on such evaluation, our principal executive officer and principal financial officer have concluded that as of such date, our disclosure controls and procedures were effective.

Management's Report on Internal Control Over Financial Reporting

This Annual Report on Form 10-K does not include a report of management's assessment regarding internal control over financial reporting or an attestation report of our registered public accounting firm due to a transition period established by rules of the Securities and Exchange Commission for newly public companies.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during our most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information.

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

The information required by this item will be set forth in our Proxy Statement for the 2015 Annual Meeting of Stockholders, or the 2015 Proxy Statement, to be filed with the SEC within 120 days of the fiscal year ended December 31, 2014 and is incorporated herein by reference.

We have a code of business ethics and conduct that applies to all of our employees, including our Principal Executive Officer, Principal Financial Officer and our Board of Directors. A copy of this code, "Code of Business Conduct and Ethics", is available on our website at http://investor.zendesk.com. We intend to satisfy the disclosure requirement under Item 5.05 of Form 8-K regarding amendment to, or waiver from, a provision of our Code of Business Conduct and Ethics by posting such information on our investor relations website under the heading "Corporate Governance" at http://investor.zendesk.com.

Item 11. Executive Compensation.

The information required by this item will be included in the 2015 Proxy Statement and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The information required by this item will be included in the 2015 Proxy Statement and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

The information required by this item will be included in the 2015 Proxy Statement and is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services.

The information required by this item will be included in the 2015 Proxy Statement and is incorporated herein by reference.

PART IV

Item 15. Exhibits, Financial Statement Schedules.

(a) The following documents are filed as part of this report:

(1) Financial statements.

The financial statements filed as part of this report are listed on the Index to Consolidated Financial Statements in Item 8.

(2) Financial Statement Schedules.

Schedules not listed above have been omitted because the information required to be set forth therein is not applicable or is shown in the financial statements or notes herein.

(3) Exhibits

The documents listed in the Exhibit Index of this report are incorporated by reference or are filed with this report, in each case as indicated therein.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

	Zendesk, Inc.	
Date: February 17, 2015	By:	/s/ Alan Black
		Alan Black Senior Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)

POWER OF ATTORNEY

Each person whose signature appears below constitutes and appoints Mikkel Svane and Alan Black, and each of them, as his or her true and lawful attorney-in-fact and agent, with full power of substitution and resubstitution, for him or her and in his or her name, place and stead, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he or she might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or any of them, or their or his substitutes, may lawfully do or cause to be done by virtue thereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

Signature	Title	Date
/s/ Mikkel Svane Mikkel Svane	Chief Executive Officer and Chair of the Board of Directors (Principal Executive Officer)	2/17/15
/s/ Alan Black Alan Black	Senior Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	2/17/15
/s/ Peter Fenton Peter Fenton	Director	2/17/15
/s/ Caryn Marooney Caryn Marooney	Director	2/17/15
/s/ Elizabeth Nelson	Director	2/17/15

Elizabeth Nelson		
/s/ Dana Stalder	Director	2/17/15
Dana Stalder		
/s/ Michelle Wilson	Director	2/17/15
Michelle Wilson		
/s/ Devdutt Yellurkar	Director	2/17/15
Devdutt Yellurkar		

87

Exhibit Index

Exhibit Number	Exhibit Description	Incorporated by Reference Form	File No.	Exhibit	Filing Date
2.1	Share Purchase and Sale Agreement by and among the Registrant, the sellers listed therein, the option holders listed therein, Zopim Technologies Pte Ltd., and the representative of the sellers and option holders listed therein, dated as of March 14, 2014.	S-1	333-195176	2.1	April 10, 2014
3.1	Amended and Restated Certificate of Incorporation of the Registrant.	10-Q	001-36456	3.1	August 7, 2014
3.2	Amended and Restated By-laws of the Registrant.	10-Q	001-36456	3.2	April 10, 2014
4.1	Form of Common Stock Certificate of the Registrant.	S-1	333-195176	4.1	May 5, 2014
4.2	Third Amended and Restated Investors' Rights Agreement by and among the Registrant and certain of its stockholders, dated as of September 5, 2012.	S-1	333-195176	4.2	April 10, 2014
10.1#	2009 Stock Option and Grant Plan, as amended, and related form agreements	S-1	333-195176	10.2	April 10, 2014
10.2#	2014 Stock Option and Incentive Plan, and related form agreements.	S-1	333-195176	10.3	May 5, 2014
10.3#	2014 Employee Stock Purchase Plan.	10-Q	001-36456	10.2	November 6, 2014
10.4#	Offer Letter between the Registrant and Alan Black, dated as of October 28, 2011.	S-1	333-195176	10.5	April 10, 2014
10.5#	Offer Letter between the Registrant and Marcus Bragg, dated as of July 25, 2013.	S-1	333-195176	10.6	April 10, 2014
10.6#	Offer Letter between the Registrant and Adrian McDermott, dated as of June 16, 2010.	S-1	333-195176	10.7	April 10, 2014
10.7	Office Lease between the Registrant and 989 Market Street, LLC, dated as of April 29, 2011.	S-1	333-195176	10.8	April 10, 2014
10.8	First Amendment to Lease between the Registrant and 989 Market Street, LLC, dated as of June 28, 2011.	S-1	333-195176	10.9	April 10, 2014
10.9	Second Amendment to Lease between the Registrant and 989 Market Street, LLC, dated as of August 11, 2011.	S-1	333-195176	10.10	April 10, 2014

10.10	Third Amendment to Lease between the Registrant and HMC Mid-Market Ventures LLC, dated as of September 11, 2013.	S-1	333-195176	10.11	April 10, 2014
10.11	Sublease between the Registrant and Zoosk, Inc., dated as of August 1, 2012.	S-1	333-195176	10.12	April 10, 2014
10.12	Lease Agreement between the Registrant and 1019 Market St. Property, LLC, dated as of September 6, 2013.	10-Q	001-36456	10.1	November 6, 2014
10.13	Loan and Security Agreement by and between the Registrant and Silicon Valley Bank, dated as of June 12, 2012.	S-1	333-195176	10.14	April 10, 2014
10.14	First Amendment and Waiver to Loan and Security Agreement by and between the Registrant and Silicon Valley Bank, dated as of June 14, 2013.	S-1	333-195176	10.15	April 10, 2014

Exhibit Number	Exhibit Description	Incorporated by Reference Form	File No.	Exhibit	Filing Date
10.15	Second Amendment to Loan and Security Agreement by and between the Registrant and Silicon Valley Bank, dated as of December 30, 2013.	S-1	333-195176	10.16	April 10, 2014
10.16	Third Amendment to Loan Security Agreement by and between the Registrant and Silicon Valley Bank, dated as of February 7, 2014.	S-1	333-195176	10.17	April 10, 2014
10.17#	Non-Employee Director Compensation Policy.	S-1	333-195176	10.18	April 23, 2014
10.18#	Executive Cash Incentive Bonus Plan.	8-K	001-36456	10.1	February 11, 2015
21.1	List of Subsidiaries of the Registrant	S-1	333-195176	21.1	April 10, 2014
23.1	Consent of Ernst & Young LLP, independent registered public accounting firm.				
31.1	Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.				
31.2	Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.				
32.1†	Certifications 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.				
101.INS	XBRL Instance Document				
101.SCH	XBRL Taxonomy Extension Schema Document				
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document				
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document				
101.LAB	XBRL Taxonomy Extension Label Linkbase Document				
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document				

#Indicates management contract or compensatory plan, contract, or agreement.
†The certifications attached as Exhibit 32.1 that accompany this Annual Report on Form 10-K, are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference into any filing of Zendesk,

Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Annual Report on Form 10-K, irrespective of any general incorporation language contained in such filing.

89