Five9, Inc.
Form 10-Q
November 04, 2015
Table of Contents

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2015

OR

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

For the transition period from to

Commission File Number: 001-36383

Five9, Inc.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	94- 3394123
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

Bishop Ranch 8
4000 Executive Parkway, Suite 400
San Ramon, CA 94583
(Address of Principal Executive Offices) (Zip Code)
(925) 201-2000
(Registrant's Telephone Number, Including Area Code)

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

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

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

Large Accelerated Filer	o	Accelerated Filer	o
Non-accelerated filer	x (Do not check if a smaller reporting Company)	Smaller Reporting Company	o

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

As of October 23, 2015, there were 50,504,265 shares of the Registrant's common stock, par value $0.001 per share, outstanding.

1

Table of Contents

FIVE9, INC.
FORM 10-Q
TABLE OF CONTENTS

Table of Contents

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which involve substantial risks and uncertainties. These statements reflect the current views of our senior management with respect to future events and our financial performance. These forward-looking statements include statements with respect to our business, expenses, strategies, losses, growth plans, product and customer initiatives, market growth projections, and our industry. Statements that include the words “expect,” “intend,” “plan,” “believe,” “project,” “forecast,” “estimate,” “may,” “sho “anticipate” and similar statements of a future or forward-looking nature identify forward-looking statements for purposes of the federal securities laws or otherwise.

Forward-looking statements address matters that involve risks and uncertainties. Accordingly, there are or will be important factors that could cause our actual results to differ materially from those indicated in these statements. These factors include the information set forth under the caption “Risk Factors” and elsewhere in this report, including the following:

- our quarterly and annual results may fluctuate significantly, may not fully reflect the underlying performance of our business and may result in decreases in the price of our common stock;
- if we are unable to attract new clients or sell additional services and functionality to our existing clients, our revenue and revenue growth will be harmed;
- our recent rapid growth may not be indicative of our future growth, and even if we continue to grow rapidly, we may fail to manage our growth effectively;
- the markets in which we participate are highly competitive, and if we do not compete effectively, our operating results could be harmed;
- if we fail to manage our technical operations infrastructure, our existing clients may experience service outages, our new clients may experience delays in the deployment of our solution and we could be subject to, among other things, claims for credits or damages;
- if our existing clients terminate their subscriptions or reduce their subscriptions and related usage, our revenues and gross margins will be harmed and we will be required to spend more money to grow our client base;
- we sell our solution to larger organizations that require longer sales and implementation cycles and often demand more configuration and integration services or customized features and functions that we may not offer, any of which could delay or prevent these sales and harm our growth rates, business and operating results;
- because a significant percentage of our revenue is derived from existing clients, downturns or upturns in new sales will not be immediately reflected in our operating results and may be difficult to discern;
- we rely on third-party telecommunications and internet service providers to provide our clients and their customers with telecommunication services and connectivity to our cloud contact center software and any failure by these service providers to provide reliable services could subject us to, among other things, claims for credits or damages;
- we have a history of losses and we may be unable to achieve or sustain profitability;
- we may not be able to secure additional financing on favorable terms, or at all, to meet our future capital needs; and
- failure to comply with laws and regulations could harm our business and our reputation.

The foregoing factors should not be construed as exhaustive and should be read together with the other cautionary statements included in this report. If one or more of these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, our actual results may differ materially from what we anticipate. You should not place undue reliance on our forward-looking statements. Any forward-looking statements you read in this report reflect our views only as of the date of this report with respect to future events and are subject to these and other risks, uncertainties and assumptions relating to our operations, results of operations, growth strategy and liquidity. We undertake no obligation to update any forward-looking statements made in this report to reflect events or circumstances after the date of this report or to reflect new information or the occurrence of unanticipated events, except as required by law.

3

Table of Contents

PART I. FINANCIAL INFORMATION
ITEM 1. Financial Statements
FIVE9, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited, in thousands, except per share data)

	September 30, 2015	December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$59,501	$58,289
Short-term investments	—	20,000
Accounts receivable, net	9,309	8,335
Prepaid expenses and other current assets	2,917	1,960
Total current assets	71,727	88,584
Property and equipment, net	12,376	12,571
Intangible assets, net	2,169	2,553
Goodwill	11,798	11,798
Other assets	800	1,428
Total assets	$98,870	$116,934
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$2,865	$4,179
Accrued and other current liabilities	8,053	7,318
Accrued federal fees	5,595	7,215
Sales tax liability	1,036	297
Notes payable	6,045	3,146
Capital leases	4,313	4,849
Deferred revenue	5,562	5,346
Total current liabilities	33,469	32,350
Revolving line of credit	12,500	12,500
Sales tax liability — less current portion	1,949	2,582
Notes payable — less current portion	19,232	22,778
Capital leases — less current portion	4,538	4,423
Other long-term liabilities	640	548
Total liabilities	72,328	75,181
Commitments and contingencies (Note 9)		
Stockholders' equity:		
Preferred stock, $0.001 par value; 5,000 shares authorized, no shares issued and outstanding at September 30, 2015 and December 31, 2014	—	—
Common stock, $0.001 par value; 450,000 shares authorized, 50,499 shares and 49,322 shares issued and outstanding at September 30, 2015 and December 31, 2014, respectively	51	49
Additional paid-in capital	177,393	170,286
Accumulated deficit	(150,902)	(128,582)
Total stockholders' equity	26,542	41,753
Total liabilities and stockholders' equity	$98,870	$116,934

See accompanying notes to condensed consolidated financial statements.

4

Table of Contents

FIVE9, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
(Unaudited, in thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	September 30, 2015	September 30, 2014	September 30, 2015	September 30, 2014
Revenue	$32,287	$25,869	$92,835	$74,828
Cost of revenue	14,812	13,504	43,860	40,121
Gross profit	17,475	12,365	48,975	34,707
Operating expenses:				
Research and development	5,473	5,503	17,079	16,282
Sales and marketing	10,797	9,296	31,322	27,992
General and administrative	6,087	7,967	19,389	17,653
Total operating expenses	22,357	22,766	67,790	61,927
Loss from operations	(4,882)	(10,401)	(18,815)	(27,220)
Other income (expense), net:				
Interest expense	(1,235)	(1,116)	(3,529)	(2,986)
Interest income and other	119	95	72	99
Change in fair value of convertible preferred and common stock warrant liabilities	—	—	—	1,745
Total other income (expense), net	(1,116)	(1,021)	(3,457)	(1,142)
Loss before provision for income taxes	(5,998)	(11,422)	(22,272)	(28,362)
Provision for income taxes	50	13	48	52
Net loss	$(6,048)	$(11,435)	$(22,320)	$(28,414)
Net loss per share:				
Basic and diluted	$(0.12)	$(0.24)	$(0.45)	$(0.84)
Shares used in computing net loss per share:				
Basic and diluted	50,369	48,310	49,931	33,762
Comprehensive Loss:				
Net loss	$(6,048)	$(11,435)	$(22,320)	$(28,414)
Other comprehensive loss:				
Change in unrealized gain/loss on short-term investments, net of tax	—	1	—	1
Comprehensive loss	$(6,048)	$(11,434)	$(22,320)	$(28,413)

See accompanying notes to condensed consolidated financial statements.

Table of Contents

FIVE9, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, in thousands)

	Nine Months Ended	
	September 30, 2015	September 30, 2014
Cash flows from operating activities:		
Net loss	$(22,320)	$(28,414)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	5,525	4,858
Provision for doubtful accounts	157	43
Stock-based compensation	6,010	4,796
Loss on the disposal of property and equipment	10	1
Non-cash interest expense	260	210
Changes in fair value of convertible preferred and common stock warrant liabilities	—	(1,745)
Others	40	(5)
Changes in operating assets and liabilities:		
Accounts receivable	(1,149)	(744)
Prepaid expenses and other current assets	(957)	(981)
Other assets	(178)	(39)
Accounts payable	(1,329)	(1,018)
Accrued and other current liabilities	788	2,558
Accrued federal fees and sales tax liability	161	(787)
Deferred revenue	192	666
Other liabilities	(83)	(158)
Net cash used in operating activities	(12,873)	(20,759)
Cash flows from investing activities:		
Purchases of property and equipment	(689)	(478)
Decrease (increase) in restricted cash	806	(25)
Purchase of short-term investments	(20,000)	(29,993)
Proceeds from maturity of short-term investments	40,000	—
Net cash provided by (used in) investing activities	20,117	(30,496)
Cash flows from financing activities:		
Net proceeds from initial public offering, net of payments for offering costs	—	71,459
Proceeds from exercise of common stock options and warrants	419	767
Proceeds from sale of common stock under ESPP	680	—
Proceeds from notes payable	—	19,561
Repayments of notes payable	(2,622)	(783)
Payments of capital leases	(4,509)	(4,008)
Net cash provided by (used in) financing activities	(6,032)	86,996
Net increase in cash and cash equivalents	1,212	35,741
Cash and cash equivalents:		
Beginning of period	58,289	17,748
End of period	$59,501	$53,489
Non-cash investing and financing activities:		
Equipment obtained under capital lease	$4,193	$4,512
Equipment purchased and unpaid at period-end	84	3
Reclass of deferred initial public offering costs to additional paid-in capital	—	2,179

Net cashless exercise of preferred stock warrants to Series A-2 convertible preferred stock	—	509
Vesting of early exercised stock options	—	185
Reclass of warrants liabilities to additional paid-in capital upon initial public offering	—	2,647
Conversion of convertible preferred stock to common stock upon initial public offering	—	54,244

See accompanying notes to the condensed consolidated financial statements.

Table of Contents

FIVE9, INC.
Notes to Condensed Consolidated Financial Statements (Unaudited)

1. Description of Business and Summary of Significant Accounting Policies

Five9, Inc. (together with its wholly-owned subsidiaries, the “Company”) is a provider of cloud contact center software. The Company was incorporated in Delaware in 2001 and is headquartered in San Ramon, California. In addition, the Company has offices in Europe and Asia, which primarily provide research, development and client support services.

Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (“GAAP”) and applicable rules and regulations of the Securities and Exchange Commission (“SEC”) regarding interim financial reporting. Certain information and note disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Therefore, these condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014. All intercompany transactions and balances have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. The significant estimates made by management affect revenue, the allowance for doubtful accounts, intangible assets, goodwill, loss contingencies, including the Company’s accrual for federal fees and sales tax liability, accrued liabilities, stock-based compensation, fair value calculations of the convertible preferred and common stock warrant liabilities, provision for income taxes and uncertain tax positions. Management periodically evaluates such estimates and they are adjusted prospectively based upon such periodic evaluation. Actual results could differ from those estimates.

Significant Accounting Policies

The Company’s significant accounting policies are disclosed in its Annual Report on Form 10-K for the year ended December 31, 2014. During the nine months ended September 30, 2015, there were no changes to the Company's significant accounting policies.

Recent Accounting Pronouncements

In April 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-05, Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement. The ASU provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The ASU does not change the accounting for a customer’s accounting for service contracts. A company can elect to adopt the ASU either prospectively or retrospectively. This guidance is effective for the Company beginning in the first quarter of 2016. Early adoption is permitted. The Company does not expect this guidance to have a material effect on its consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. The ASU requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by this ASU. In August 2015, the FASB issued ASU No. 2015-15, Interest—Imputation of Interest (Subtopic 835-30): Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements, which clarifies that the SEC staff would not object to an entity deferring and presenting debt

issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. Early adoption is permitted. This guidance is effective for the Company on a retrospective basis beginning in the first quarter of 2016 and is not expected to have a material effect on the Company's consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern. The new guidance requires management of public and private companies to evaluate whether there is substantial doubt about the entity’s ability to continue as a going concern and, if so, disclose that fact. Management will also be required to evaluate and disclose whether its plans alleviate that doubt. The standard will be effective for the Company's annual period ending December 31, 2016 and interim and annual periods thereafter. Early adoption is permitted. The Company does not expect that the requirement will have an impact on its financial position, results of operations or cash flows.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The ASU No. 2014-09 is originally effective for the Company's annual and interim reporting periods beginning January 1, 2017. The standard permits the use of either the retrospective or cumulative effect transition method. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which defers the effective date of ASU 2014-09 for all entities by one year while providing an option to early adopt the standard on the original effective date. Accordingly, the new revenue standard is effective for the Company's annual and interim reporting periods beginning January 1, 2018. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

2. Fair Value Measurements

The Company carries cash equivalents and short-term investments consisting of money market funds and marketable securities at fair value on a recurring basis. Fair value is based on the price that would be received from selling an asset in an orderly transaction between market participants at the measurement date. Fair value is estimated by applying the following hierarchy, which prioritizes the inputs used to measure fair value into three levels and bases the categorization within the hierarchy upon the lowest level of input that is available and significant to the fair value measurement:

Level 1 — Observable inputs which include unadjusted quoted prices in active markets for identical assets.

Level 2 — Observable inputs other than Level 1 inputs, such as quoted prices for similar assets, quoted prices for identical or similar assets in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset.

Level 3 — Unobservable inputs that are supported by little or no market activity and that are based on management’s assumptions, including fair value measurements determined by using pricing models, discounted cash flow methodologies or similar techniques.

The fair value of assets carried at fair value was determined using the following inputs (in thousands):

	September 30, 2015	
	Total	Level 1
Assets		
Cash equivalents:		
Money market funds	$20,005	$20,005

	December 31, 2014	
	Total	Level 1
Assets		
Short-term investments:		

U.S. Treasury bills	$20,000	$20,000

8

Table of Contents

3. Financial Statement Components

Cash and cash equivalents consisted of the following (in thousands):

	September 30, 2015	December 31, 2014
Cash	$39,496	$58,289
Money market funds	20,005	—
Cash and cash equivalents	$59,501	$58,289

Restricted Cash

As of September 30, 2015, the Company's restricted cash balance was not material. As of December 31, 2014, the Company had restricted cash of $0.8 million that included $0.7 million related to a letter of credit issued to the Company’s landlord with respect to its lease obligation and $0.1 million under letters of credit primarily related to an insurance policy. These letters of credit had been released during the first half of 2015. Restricted cash is included in 'Other assets' on the accompanying condensed consolidated balance sheets.

Accounts receivable, net consisted of the following (in thousands):

	September 30, 2015	December 31, 2014
Trade accounts receivable	$8,488	$7,482
Unbilled trade accounts receivable, net of advance client deposits	839	918
Allowance for doubtful accounts	(18)	(65)
Accounts receivable, net	$9,309	$8,335

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

	September 30, 2015	December 31, 2014
Computer and network equipment	$28,412	$24,292
Computer software	2,961	2,264
Internal-use software development costs	74	—
Furniture and fixtures	1,061	1,030
Leasehold improvements	611	611
Property and equipment	33,119	28,197
Accumulated depreciation and amortization	(20,743)	(15,626)
Property and equipment, net	$12,376	$12,571

Depreciation and amortization expense associated with property and equipment was $1.7 million and $5.1 million for the three and nine months ended September 30, 2015, respectively, and $1.5 million and $4.5 million for the three and nine months ended September 30, 2014, respectively.

Property and equipment capitalized under capital lease obligations consist primarily of computer and network equipment and were as follows (in thousands):

	September 30, 2015	December 31, 2014
Gross	$25,211	$21,025
Less: accumulated depreciation and amortization	(14,086)	(10,609)
Total	$11,125	$10,416

Table of Contents

Accrued and other current liabilities consisted of the following (in thousands):

	September 30, 2015	December 31, 2014
Accrued compensation and benefits	$6,025	$5,078
Accrued expenses	2,028	2,240
Accrued and other current liabilities	$8,053	$7,318

4. Intangible Assets

The components of intangible assets, which were acquired in connection with the Company’s acquisition of Face It, Corp., which the Company refers to as SoCoCare, a social engagement and mobile customer care solution provider, in October 2013, were as follows (in thousands):

	September 30, 2015			December 31, 2014		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	$2,460	$(687)	$1,773	$2,460	$(423)	$2,037
Customer relationships	520	(203)	317	520	(125)	395
Domain names	50	(20)	30	50	(12)	38
Non-compete agreements	140	(91)	49	140	(57)	83
Total	$3,170	$(1,001)	$2,169	$3,170	$(617)	$2,553

Amortization expense related to intangible assets was $0.1 million and $0.4 million for the three and nine months ended September 30, 2015, respectively, and $0.1 million and $0.4 million for the three and nine months ended September 30, 2014, respectively.

As of September 30, 2015, the expected future amortization expense for intangible assets was as follows (in thousands):

Period	Expected Future Amortization Expense
Remainder of 2015	$128
2016	503
2017	465
2018	442
2019	351
2020	280
Total	$2,169

5. Long-Term Debt

2013 Loan and Security Agreement

The Company has a revolving line of credit of up to $20.0 million ("Revolving Credit Facility") under a loan and security agreement with a lender, which was entered into in March 2013 and last amended in December 2014 (“2013 Loan and Security Agreement”). The Revolving Credit Facility carries a variable annual interest rate of the prime rate plus 0.50% and matures on December 1, 2016.

The 2013 Loan and Security Agreement is collateralized by substantially all the assets of the Company. The balance outstanding cannot exceed the lesser of (i) $20.0 million or (ii) an amount equal to the Company’s monthly recurring revenue for the three months prior multiplied by the average Dollar-Based Retention Rate over the prior twelve months, less the amount accrued for the Company’s Universal Service Fund ("USF") obligation (accrued federal fees). As of September 30, 2015, the outstanding principal balance under the Revolving Credit Facility was $12.5 million, which has been disclosed as a non-current liability, and the amount available for additional borrowings was $7.5 million.

Table of Contents

In connection with its acquisition of SoCoCare, the Company also borrowed $5.0 million under a term loan (the “Term Loan”) under the 2013 Loan and Security Agreement in October 2013. Monthly interest-only payments were due on the advance at the prime rate plus 1.50% through September 2014. Principal and interest payments are due in equal monthly installments from October 2014 through the maturity of the Term Loan in March 2017. As of September 30, 2015 and December 31, 2014, approximately $3.0 million and $4.5 million, respectively, of this Term Loan was outstanding and is included as notes payable in the condensed consolidated balance sheets.

The 2013 Loan and Security Agreement contains certain covenants, including the requirement that the Company maintain $7.5 million of cash deposited with the lender for the term of the 2013 Loan and Security Agreement. The Company was in compliance with these covenants as of September 30, 2015. The 2013 Loan and Security Agreement remains senior to other debts, including the debt issued under the 2014 Loan and Security Agreement discussed below.

2014 Loan and Security Agreement

The Company has a term loan facility of $30.0 million with a syndicate of two lenders ("Lenders"), which was entered into in February 2014 and amended in December 2014 and February 2015 (the “2014 Loan and Security Agreement”). The term loan facility is available to the Company in tranches; the first tranche for $20.0 million was advanced upon the closing of the agreement and the remaining $10.0 million is available for drawdown by the Company until February 2016 in $1.0 million increments. The Company incurred $0.4 million in debt issuance costs in connection with borrowing the first tranche in February 2014. The term loan bears interest at a variable per annum rate equal to the greater of 10% or LIBOR plus 9%. Interest is due and payable on the last business day of each month during the term of the loan commencing in February 2014. Monthly principal payments are due beginning in February 2016 based on 1/60th of the outstanding balance at that time and will continue until all remaining principal outstanding under the term loan becomes due and payable in February 2019. All amounts outstanding under this loan facility have been disclosed as part of 'Notes payable - less current portion' in the condensed consolidated balance sheet as of September 30, 2015.

The term loan is secured by substantially all the assets of the Company and is subordinate to the 2013 Loan and Security Agreement. The 2014 Loan and Security Agreement contains certain covenants and includes the occurrence of a material adverse event, as defined in the agreement and determined by the Lenders, as an event of default. As of September 30, 2015, the Company was in compliance with these covenants.

In connection with entering into the 2014 Loan and Security Agreement, the Company issued to the Lenders warrants to purchase 177,865 shares of common stock at $10.12 per share, which vest and become exercisable over a ten year term from the date of issuance, based on amounts drawn under the $30.0 million term loan facility. Based on the drawdown of $20.0 million in February 2014, 118,577 shares of common stock issuable under the warrants vested and are exercisable by the Lenders. As of September 30, 2015, 59,288 shares of common stock issuable under the warrants pertaining to the undrawn $10.0 million were unvested.

Promissory Note

In July 2013, the Company issued a promissory note to the Universal Service Administrative Company ("USAC") for $4.1 million in principal amount as a financing arrangement for that amount of accrued federal fees. The promissory note carries a fixed annual interest rate of 12.75% and is repayable in 42 equal monthly installments of principal and interest beginning in August 2013. As of September 30, 2015 and December 31, 2014, approximately $1.7 million and $2.6 million in principal amount, respectively, of this promissory note was outstanding and is included as notes payable in the accompanying condensed consolidated balance sheets.

FCC Civil Penalty

In June 2015, the Company entered into a consent decree with the Federal Communications Commission (“FCC”) Enforcement Bureau (Note 9), in which the Company agreed to pay a civil penalty of $2.0 million to the U.S. Treasury in twelve equal quarterly installments starting in July 2015 without interest. As a result, the Company discounted the $2.0 million liability, which was accrued in the third quarter of 2014 for the then tentative civil penalty, to its present value of $1.7 million to reflect the imputed interest and reclassified this discounted liability from 'Accrued federal fees' to 'Notes payable.' The $0.3 million discount was recorded as a reduction to general and administrative expense in the three months ended June 30, 2015 and is being recognized as interest expense over the payment term of the civil penalty. As of September 30, 2015, the outstanding civil penalty payable was $1.8 million, of which the net carrying value was $1.6 million and is included as 'Notes payable' in the accompanying condensed consolidated balance sheets.

Table of Contents

As of September 30, 2015 and December 31, 2014, the Company's outstanding debt is summarized as follows (in thousands):

	September 30, 2015	December 31, 2014
Term loan under 2014 Loan and Security Agreement	$20,000	$20,000
Term loan under 2013 Loan and Security Agreement	3,000	4,500
Promissory note to USAC	1,667	2,640
FCC civil penalty	1,833	—
Total notes payable, gross	26,500	27,140
Less: discount	(1,223)	(1,216)
Total notes payable, net carrying value	25,277	25,924
Revolving line of credit, non-current	12,500	12,500
Total debt, net carrying value	$37,777	$38,424
Less: current portion of debt	(6,045)	(3,146)
Total debt, less current portion *	31,732	35,278

* Included in 'Revolving line of credit' and 'Notes payable - less current portion' in the condensed consolidated balance sheets.

Maturities of the Company's outstanding debt as of September 30, 2015 are as follows (in thousands):

Period	Amount to Mature
Remainder of 2015	$874
2016	20,173
2017	5,286
2018	4,334
2019	8,333
Total	$39,000

6. Stockholders' Equity

Capital Structure

The Company is authorized to issue 450,000,000 shares of common stock with a par value of $0.001 per share. As of September 30, 2015, the Company had 50,498,973 shares of common stock issued and outstanding.

The Company is also authorized to designate and issue up to 5,000,000 shares of preferred stock with a par value of $0.001 per share in one or more series without stockholder approval and to fix the rights, preferences, privileges and restrictions thereof. As of September 30, 2015, the Company had no shares of preferred stock issued and outstanding.

Common Stock Subject to Forfeiture

In connection with employment and service agreements entered into in connection with the Company's acquisition of SoCoCare in October 2013 ("Acquisition Date"), the Company issued 118,577 shares of unvested restricted common stock, the vesting of which was contingent upon continuing employment or services and subject to forfeiture. These shares were valued at $8.48 per share based on the Acquisition Date fair value of the Company's common stock. This amount was recorded as stock-based compensation on a straight-line basis over the requisite service periods. During October 2014, 50% of such shares vested. During the three months ended March 31, 2015, in accordance with the applicable stock issuance agreement, the vesting on 37,905 shares accelerated in connection with the termination of employment of a shareholder. During the three months ended June 30, 2015, the remaining 21,384 unvested shares were forfeited as a result of terminations of employment of the remaining employee-shareholders. As of December 31, 2014, the 59,289 shares that were subject to forfeiture were included in issued and outstanding shares of common stock.

Table of Contents

Warrants

As of September 30, 2015 and December 31, 2014, the Company had outstanding warrants to purchase 359,596 shares of common stock with a weighted-average exercise price of $5.59 per share, which expire on various dates between February 2020 and February 2024.

Common Stock Reserved for Future Issuance

As of September 30, 2015, shares of common stock reserved for future issuance related to outstanding equity awards, common stock warrants, and employee equity incentive plans were as follows (in thousands):

	September 30, 2015
Stock options outstanding	6,553
Restricted stock units outstanding	1,606
Shares available for future grant under 2014 Plan	5,197
Shares available for future issuance under ESPP	1,058
Common stock warrants outstanding	360
Total shares of common stock reserved	14,774

Equity Incentive Plans

Prior to the Initial Public Offering ("IPO"), the Company granted stock options under its Amended and Restated 2004 Equity Incentive Plan, as amended (the “2004 Plan”).

In March 2014, the Company’s board of directors and stockholders approved the 2014 Equity Incentive Plan (“2014 Plan”) and 5,300,000 shares of common stock were reserved for issuance under the 2014 Plan. In addition, on the first day of each year beginning in 2015 and ending in 2024, the 2014 Plan provides for an annual automatic increase to the shares reserved for issuance in an amount equal to 5% of the total number of shares outstanding on December 31st of the preceding calendar year or a lesser number as determined by the Company’s board of directors. Pursuant to the automatic annual increase, 2,466,124 additional shares were reserved under the 2014 Plan on January 1, 2015.

Upon the effectiveness of the 2014 Plan on April 3, 2014, no future grants will be made under the 2004 Plan. All shares reserved under the 2004 Plan became available for grant under the 2014 Plan. Any forfeited or expired shares that would otherwise return to the 2004 Plan after the IPO instead return to the 2014 Plan. As of September 30, 2015, 5,196,762 shares of common stock were available for future grant under the 2014 Plan.

The 2004 Plan and the 2014 Plan are described in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014.

Stock Options

A summary of the Company’s stock option activities during the nine months ended September 30, 2015 is as follows (in thousands, except years and per share data):

	Number of Shares Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Outstanding as of December 31, 2014	7,164	$4.34		
Options granted (weighted average grant date fair value of $2.40 per share)	234	5.02		
Options exercised	(565)	0.75		
Options forfeited or expired	(280)	7.20		
Outstanding as of September 30, 2015	6,553	$4.56	6.8	$7,478

Table of Contents

The Company has computed the aggregate intrinsic value amounts disclosed in the above table based on the difference between the original exercise price of the options and the fair market value of the Company’s common stock of $3.70 as of September 30, 2015 for all in-the-money options outstanding.

Restricted Stock Units

A summary of the Company's restricted stock units ("RSU") activities during the nine months ended September 30, 2015 is as follows (in thousands, except per share data):

	Number of Shares	Weighted Average Grant Date Fair Value Per Share
Outstanding as of December 31, 2014	1,370	$5.21
RSUs granted	839	4.82
RSUs vested and released	(475)	5.91
RSUs forfeited	(128)	5.17
Outstanding as of September 30, 2015	1,606	$4.81

Employee Stock Purchase Plan

The Company's 2014 Employee Stock Purchase Plan ("ESPP") became effective on April 3, 2014 and is described in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014. The number of shares of common stock originally reserved for issuance under the ESPP was 880,000 shares, which will increase automatically each year, beginning on January 1, 2015 and continuing through January 1, 2024, by the lesser of (i) 1% of the total number of shares of the Company’s common stock outstanding on December 31 of the preceding calendar year; (ii) 1,000,000 shares of common stock (subject to adjustment to reflect any split or combination of the Company’s common stock); or (iii) such lesser number as determined by the Company’s board of directors. Pursuant to the automatic annual increase, 493,224 additional shares were reserved under the ESPP on January 1, 2015. As of September 30, 2015, 1,058,251 shares of common stock were available for future issuance under the ESPP.

During the three months ended September 30, 2015, no shares were purchased under the ESPP. During the nine months ended September 30, 2015, 158,842 shares were purchased on May 15, 2015 at a weighted-average price of $4.28 per share under the ESPP.

Stock-Based Compensation

Stock-based compensation expenses for the three and nine months ended September 30, 2015 and 2014 are as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2015	September 30, 2014	September 30, 2015	September 30, 2014
Cost of revenue	$233	$158	$639	$366
Research and development	475	583	1,389	1,404
Sales and marketing	448	361	1,430	1,055
General and administrative	789	775	2,552	1,971
Total stock-based compensation	$1,945	$1,877	$6,010	$4,796

As of September 30, 2015, unrecognized stock-based compensation expenses by award type, net of estimated forfeitures, and their expected weighted-average recognition periods are summarized in the following table (in thousands, except years).

	Stock Option	RSU	ESPP
Unrecognized stock-based compensation expense	$7,906	$6,316	$63
Weighted-average amortization period	2.3 years	2.9 years	0.1 years

The Company recognizes stock-based compensation expense that is calculated based upon awards ultimately expected to vest and, thus, stock-based compensation expense is reduced for estimated forfeitures. Forfeitures are

Table of Contents

estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. All stock-based compensation for equity awards granted to employees and non-employee directors is measured based on the grant date fair value of the award.

The Company values RSUs at the closing market price of its common stock on the date of grant. The Company estimates the fair value of each stock option and purchase right under the ESPP granted to employees on the date of grant using the Black-Scholes option-pricing model and using the assumptions noted in the below table. The weighted-average assumptions used to value stock options granted during the three and nine months ended September 30, 2015 and 2014 were as follows:

Stock Options	Three Months Ended		Nine Months Ended	
	September 30, 2015	September 30, 2014	September 30, 2015	September 30, 2014
Expected term (years)	6.1	6.1	6.1	6.1
Volatility	48%	55%	49%	56%
Risk-free interest rate	1.6%	1.8%	1.5%	1.8%
Dividend yield	—	—	—	—

7. Net Loss Per Share

Basic net loss per share is calculated by dividing net loss by the weighted average number of common shares outstanding during the period, and excludes any dilutive effects of employee stock-based awards and warrants. Diluted net income per share is computed giving effect to all potentially dilutive common shares, including common stock issuable upon exercise of stock options and warrants and vesting of restricted stock. As the Company had net losses for the three and nine months ended September 30, 2015 and 2014, all potentially issuable common shares were determined to be anti-dilutive.

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

	Three Months Ended		Nine Months Ended	
	September 30, 2015	September 30, 2014	September 30, 2015	September 30, 2014
Net loss	$(6,048)	$(11,435)	$(22,320)	$(28,414)
Weighted-average shares used in computing basic and diluted net loss per share	50,369	48,310	49,931	33,762
Basic and diluted net loss per share	$(0.12)	$(0.24)	$(0.45)	$(0.84)

The following securities were excluded from the calculation of diluted net loss per share because their effect would have been anti-dilutive for the periods presented (in thousands).

	September 30, 2015	September 30, 2014
Stock options	6,553	6,968
Restricted stock units	1,606	545
ESPP	189	383
Common stock warrants	360	360
Common stock subject to repurchase or forfeiture	—	120
Total	8,708	8,376

8. Income Taxes

The provision for income taxes for the three and nine months ended September 30, 2015 was approximately $50 thousand and $48 thousand, respectively. The provision for income taxes for the three and nine months ended September 30, 2014 was approximately $13 thousand and $52 thousand, respectively. The provision for income taxes consisted primarily of foreign income taxes.

Table of Contents

For the three and nine months ended September 30, 2015 and 2014, the provision for income taxes differed from the statutory amount primarily because the Company did not realize a tax benefit for current year losses as it maintained a full valuation allowance against its domestic and foreign net deferred tax assets.

The realization of tax benefits of deferred tax assets is dependent upon future levels of taxable income, of an appropriate character, in the periods the items are expected to be deductible or taxable. Based on the available objective evidence, the Company does not believe it is more likely than not that the net deferred tax assets will be realizable. Accordingly, the Company has provided a full valuation allowance against the domestic and foreign net deferred tax assets as of September 30, 2015 and December 31, 2014. The Company intends to maintain the valuation allowance until sufficient positive evidence exists to support a reversal of, or decrease in, the valuation allowance.

During the three and nine months ended September 30, 2015, there were no material changes to the total amount of unrecognized tax benefits.

9. Commitments and Contingencies

Commitments

The Company’s principal commitments consist of obligations under operating lease agreements for offices, research and development, and sales and marketing facilities, capital leases to finance data centers and other computer and networking equipment purchases and agreements with third parties to provide co-location hosting and telecommunication usage services. These commitments as of December 31, 2014 are disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2014, and did not change materially during the nine months ended September 30, 2015 except for the acquisition of certain additional data center and network equipment and software under multiple capital leases. As of September 30, 2015, the total minimum future payment commitments under these capital leases were approximately \$4.4 million, of which \$0.4 million is due in 2015, with the remainder due over approximately 2.9 years thereafter.

Universal Services Fund Liability

During the third quarter of 2012, the Company determined that based on its business activities, it is classified as a telecommunications service provider for regulatory purposes and it should make direct contributions to the federal USF and related funds based on revenues it receives from the resale of interstate and international telecommunications services. Previously, the Company had believed that the telecommunications services were an integral part of an information service that the Company provides via its software and had instead made indirect USF contributions via payments to its wholesale telecommunications service providers. In order to comply with the obligation to make direct contributions, the Company made a voluntary self-disclosure to the FCC Enforcement Bureau and has registered with the USAC, which is charged by the FCC with administering the USF. The Company has filed exemption certificates with its wholesale telecommunications service providers in order to eliminate its obligation to reimburse such wholesale telecommunications service providers for their USF contributions calculated on services sold to the Company.

The Company’s registration with USAC subjects it to assessments for unpaid USF contributions, as well as interest thereon and civil penalties, due to its late registration and past failure to recognize its obligation as a USF contributor and as an international carrier. The Company will be required to pay assessments for periods prior to the Company’s registration. As of December 31, 2012, the total past due USF contribution being imposed by USAC and accrued by the Company for the period from 2003 through 2012 was \$8.1 million, of which \$4.7 million was undisputed and \$3.4 million, including \$0.8 million that pertains to 2003 through 2007, was disputed. While the Company is in administrative proceedings before the FCC to limit such back assessments to the period 2008 through 2012, it is possible that it will be required to pay back assessments for the period from 2003 through 2007. In 2013, the Company began remitting required contributions on a prospective basis directly to USAC.

In July 2013, the Company and USAC agreed to a financing arrangement for \$4.1 million of the undisputed \$4.7 million of the unpaid USF contributions whereby the Company issued to USAC a promissory note payable in the principal amount of the \$4.1 million and paid off the remaining undisputed \$0.6 million. The repayment terms of the promissory note payable are disclosed in Note 5. As of September 30, 2015 and December 31, 2014, the principal balance of the promissory note payable was \$1.7 million and \$2.6 million, respectively, and is included in the notes payable amounts on the condensed consolidated balance sheets. In addition to the promissory note payable, as of September 30, 2015 and December 31, 2014, the Company had an accrued liability for the disputed portion of the unpaid USF contributions and estimated interest and penalties of $4.5 million and $4.2 million, respectively, included in accrued federal fees on the condensed consolidated balance sheets. For the three and nine months ended

16

Table of Contents

September 30, 2015, the Company recorded interest and penalty expenses of $0.1 million and $0.4 million, respectively, as a charge to general and administrative expense, which were related to its disputed unpaid USF obligations.

In June 2015, in connection with the Company's late registration with the USAC and past failure to recognize its obligation as a USF contributor and as an international carrier from 2003 to 2012, the Company entered into a consent decree with the FCC Enforcement Bureau. In the consent decree, the Company agreed to pay a civil penalty of $2.0 million to the U.S. Treasury in twelve equal quarterly installments starting in July 2015 without interest (Note 5). In the third quarter of 2014, the Company had accrued a $2.0 million liability for the then tentative civil penalty. The consent decree also requires the Company to adopt certain internal regulatory compliance monitoring and training requirements, and to report on the status of those compliance efforts to the FCC's Enforcement Bureau during a period of three years.

State and Local Taxes and Surcharges

In April 2012, the Company commenced collecting and remitting sales taxes on sales of subscription services in all the U.S. states in which it determined it was obligated to do so. During the first quarter of 2015, the Company conducted an updated sales tax review of the taxability of sales of its subscription services. As a result, the Company determined that it may be obligated to collect and remit sales taxes on such sales in four additional states. Based on its best estimate of the probable sales tax liability in those four states relating to its sales of subscription services during the period 2011 through 2014, for the three months ended March 31, 2015, the Company recorded a general and administrative expense of $0.6 million as an immaterial out of period adjustment to accrue for such taxes.

During 2013, the Company analyzed its activities and determined it may be obligated to collect and remit various state and local taxes and surcharges on its usage-based fees. The Company had not remitted state and local taxes on usage-based fees in any of the periods prior to 2014 and therefore accrued a sales tax liability for this contingency. In January 2014, the Company commenced paying such taxes and surcharges to certain state authorities. In June 2014, the Company commenced collecting state and local taxes or surcharges on usage-based fees from its clients on a current basis and remitting such taxes to the applicable U.S. state taxing authorities.

During the three and nine months ended September 30, 2015, the Company has remitted $0.1 million and $1.0 million for its contingent sales taxes on both usage-based fees and sales of subscription services. For the three and nine months ended September 30, 2015, the Company recognized $17 thousand and $1.0 million, respectively, as general and administrative expense related to its estimated sales tax liability on both usage-based fees and sales of subscription services in the U.S. and Canada, which was not being collected from its clients. During 2015, the Company expects to commence collecting such sales taxes from its clients on a current basis and remitting such taxes to the applicable taxing authorities.

As of September 30, 2015, the Company had total accrued liabilities of $2.6 million for such contingent sales taxes and surcharges that were not being collected from its clients but may be imposed by various taxing authorities, of which $0.7 million and $1.9 million was included in current and non-current "Sales tax liability" on the condensed consolidated balance sheets, respectively. As of December 31, 2014, the Company had total accrued liabilities of $2.6 million for such contingent sales taxes and surcharges, which was included in non-current "Sales tax liability" on the condensed consolidated balance sheets. The Company's estimate of the probable loss incurred under this contingency is based on its analysis of the source location of its usage-based fees and the regulations and rules in each tax jurisdiction.

Legal Matters

The Company is involved in various legal and regulatory matters arising in the normal course of business. In management's opinion, resolution of these matters is not expected to have a material impact on the Company's consolidated results of operations, cash flows, or its financial position. However, depending on the nature and timing of any such dispute, an unfavorable resolution of a matter could materially affect the Company's future consolidated results of operations, cash flows or financial position in a particular period.

The Company is currently involved in the following lawsuit as a defendant.

NobelBiz Litigation

In April 2012, NobelBiz, Inc., a telecommunication solutions company, brought a patent infringement lawsuit in the U.S. District Court for the Eastern District of Texas against the Company seeking a permanent injunction,

Table of Contents

damages and attorneys' fees. The Company responded to the complaint and preliminary injunction request by asserting non-infringement and invalidity of the patent.
In March 2013, the court granted the Company's motion to transfer the case to the U.S. District Court for the Northern District of California subsequent to which the complainant amended its claim to include another related patent. The Company has responded to this amended claim by continuing to assert non-infringement and invalidity of the patents. During December 2013, the court in California held a status conference and subsequently held a claim construction hearing regarding the patents on August 22, 2014. On January 16, 2015, the court issued an order regarding claim construction of the two patents-in-suit. A trial date of June 20, 2016 has been set in the event that the case is not resolved by summary judgment motions. The deadline for filing summary judgment motions is March 4, 2016. The Company has investigated the claims alleged in the complaint and believes that it has good defenses to the claims. Accordingly, the Company has not accrued a loss related to this matter as the Company does not believe that it is probable that a loss will be incurred.
The Company recognizes general and administrative expense for legal fees in the period the services are provided.
Indemnification Agreements
In the ordinary course of business, the Company indemnifies various clients, vendors, lessors, business partners and other parties with respect to certain matters, including, but not limited to, losses arising out of breach of such agreements, services to be provided by the Company or from intellectual property infringement claims made by third parties. In addition, the Company has entered into indemnification agreements with its directors, officers and certain employees that require the Company, among other things, to indemnify them against certain liabilities that may arise by reason of their status or service as directors, officers or employees. No demands have been made upon the Company to provide indemnification under such agreements and thus there are no claims that the Company is aware of that would have a material effect on the Company’s condensed consolidated balance sheets, condensed consolidated statements of operations and comprehensive loss, or condensed consolidated statements of cash flows.

10. Geographical Information
The following table is a summary of revenues by geographic region based on client billing address and has been estimated based on the amounts billed to clients during the periods (in thousands).

	Three Months Ended		Nine Months Ended	
	September 30, 2015	September 30, 2014	September 30, 2015	September 30, 2014
United States	$29,987	$23,879	$86,353	$69,130
International	2,300	1,990	6,482	5,698
Total revenue	$32,287	$25,869	$92,835	$74,828

The following table summarizes total property and equipment, net in the respective locations (in thousands).

	September 30, 2015	December 31, 2014
United States	$10,408	$10,625
International	1,968	1,946
Property and equipment, net	$12,376	$12,571

ITEM 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations
You should read the following discussion in conjunction with the condensed consolidated financial statements and notes thereto included elsewhere in this report and our Annual Report on Form 10-K for the year ended December 31, 2014. In addition to historical information, this discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 that involve risks and uncertainties that could cause our actual results to differ materially from our expectations. Factors that could cause such differences include, but are not limited to, those described in the section titled “Risk Factors” and elsewhere in this report.

Table of Contents

Overview

We are a pioneer and leading provider of cloud software for contact centers, facilitating over three billion interactions between our more than 2,000 clients and their customers per year. We believe we achieved this leadership position through our expertise and technology, which has empowered us to help organizations of all sizes transition from legacy on-premise contact center systems to our cloud solution. Our solution, which is comprised of our Virtual Contact Center ("VCC") cloud platform and applications, allows simultaneous management and optimization of customer interactions across voice, chat, email, web, social media and mobile channels, either directly or through our application programming interfaces. Our VCC cloud platform routes each customer interaction to an appropriate agent resource, and delivers relevant customer data to the agent in real-time to optimize the customer experience. Unlike legacy on-premise contact center systems, our solution requires minimal up-front investment and can be rapidly deployed and adjusted depending on our client’s requirements.

Since founding our business in 2001, we have focused exclusively on delivering cloud contact center software. We initially targeted smaller contact center opportunities with our telesales team and, over time, invested in expanding the breadth and depth of the functionality of our cloud platform to meet the evolving requirements of our clients. In 2009, we made a strategic decision to expand our market opportunity to include larger contact centers. This decision drove further investments in research and development and the establishment of our field sales team to meet the requirements of these larger contact centers. We believe this shift has helped us diversify our client base while significantly enhancing our opportunity for future revenue growth. To complement these efforts, we have also focused on building client awareness and driving adoption of our solution through marketing activities, which include internet advertising, digital marketing campaigns, social marketing, trade shows, industry events and telemarketing.

We provide our solution through a Software as a Service ("SaaS") business model with recurring subscriptions. We offer a comprehensive suite of applications delivered on our VCC cloud platform that are designed to enable our clients to manage and optimize interactions across inbound and outbound contact centers. We primarily generate revenue by selling subscriptions and related usage of our VCC cloud platform. We charge our clients monthly subscription fees for access to our solution, primarily based on the number of agent seats, as well as the specific functionalities and applications our clients deploy. We define agent seats as the maximum number of named agents allowed to concurrently access our solution. Our clients typically have more named agents than agent seats, and multiple named agents may use an agent seat, though not simultaneously. Substantially all of our clients purchase both subscriptions and related usage from us. A small percentage of our clients subscribe to our platform but purchase telephony usage directly from wholesale telecommunications service providers. We do not sell telephony usage on a stand-alone basis to any client. The related usage fees are based on the volume of minutes for inbound and outbound interactions. We also offer bundled plans, generally for smaller deployments, where the client is charged a single monthly fixed fee per agent seat that includes both subscription and unlimited usage in the contiguous 48 states and, in some cases, Canada. We offer monthly, annual and multiple-year contracts to our clients, generally with 30 days’ notice required for changes in the number of agent seats. Our clients can use this notice period to rapidly adjust the number of agent seats used to meet their changing contact center volume needs, including to reduce the number of agent seats to zero. As a general matter, this means that a client can effectively terminate its agreement with us upon 30 days’ notice. Our larger clients typically choose annual contracts, which generally include an implementation and ramp period of several months. Fixed subscription fees, including bundled plans, are generally billed monthly in advance, while related usage fees are billed in arrears. For the three and nine months ended September 30, 2015, subscription and related usage fees accounted for 96% and 97% of our revenue, respectively. For the three and nine months ended September 30, 2014, subscription and related usage fees accounted for 97% of our revenue. The remainder was comprised of professional services revenue from the implementation and optimization of our solution.

Our revenue increased to $32.3 million and $92.8 million for the three and nine months ended September 30, 2015 from $25.9 million and $74.8 million for the three and nine months ended September 30, 2014. Revenue growth has primarily been driven by new clients choosing to use our solution and to a lesser extent, existing clients gradually increasing the number of agent seats under subscription. For each of the three and nine months ended September 30, 2015 and 2014, no single client accounted for more than 10% of our total revenue. As of September 30, 2015, we had over 2,000 clients across multiple industries. Our clients' subscriptions generally range in size from fewer than 10 agent seats to approximately 1,000 agent seats.

We have continued to make significant expenditures and investments, including in sales and marketing, research and development and infrastructure. We primarily evaluate the success of our business based on revenue growth and the efficiency and effectiveness of our investments. The growth of our business and our future success

Table of Contents

depend on many factors, including our ability to continue to expand our client base to include larger opportunities, grow revenue from our existing client base, innovate and expand internationally. While these areas represent significant opportunities for us, they also pose risks and challenges that we must successfully address in order to sustain the growth of our business and improve our operating results.

In order to pursue these opportunities, we anticipate that we will continue to expand our operations and headcount in the near term. The expected addition of new employees and the investments that we anticipate will be necessary to manage our anticipated growth will make it more difficult for us to generate earnings.

Due to our continuing investments to grow our business, increase our sales and marketing efforts, pursue new opportunities, enhance our solution and build our technology, we expect our cost of revenue and operating expenses to increase in absolute dollars in future periods. However, we expect these expenses as a percentage of revenue to decrease as we grow our revenue and gain economies of scale by increasing our client base without direct incremental development costs and by utilizing more of the capacity of our data centers.

Key Operating and Financial Performance Metrics

In addition to measures of financial performance presented in our condensed consolidated financial statements, we monitor the key metrics set forth below to help us evaluate growth trends, establish budgets, measure the effectiveness of our sales and marketing efforts and assess operational efficiencies.

Dollar-Based Retention Rate

We believe that our Dollar-Based Retention Rate provides insight into our ability to retain and grow revenue from our clients, and is a measure of the long-term value of our client relationships. Our Dollar-Based Retention Rate is calculated by dividing our Retained Net Invoicing by our Retention Base Net Invoicing on a monthly basis, which we then average using the rates for the trailing twelve months for the period being presented. We define Retention Base Net Invoicing as recurring net invoicing from all clients in the comparable prior year period, and we define Retained Net Invoicing as recurring net invoicing from that same group of clients in the current period. We define recurring net invoicing as subscription and related usage revenue excluding the impact of service credits, reserves and deferrals. Historically, the difference between recurring net invoicing and our subscription and related usage revenue has been within 10%.

The following table shows our Dollar-Based Retention Rate for the periods presented:

	Twelve Months Ended	
	September 30, 2015	September 30, 2014
Dollar-Based Retention Rate	95%	97%

The year-over-year decline in our Dollar-Based Retention Rate was primarily due to several clients who provide support for Affordable Care Act ("ACA") enrollment. Our recurring net invoicing to these clients increased significantly in the twelve months ended September 30, 2014 compared to the twelve months ended September 30, 2013 due to intense and extended activity during the initial roll out of the ACA. In the twelve months ended September 30, 2015, we did not experience the same growth rate in the recurring net invoicing from ACA clients as we had in the twelve months ended September 30, 2014, because enrollees were more familiar with the process, requiring less support, and, unlike the prior year, the enrollment deadline was not extended. As a result, our Dollar-Based Retention Rate declined from September 30, 2014 to September 30, 2015.

Adjusted EBITDA

We monitor Adjusted EBITDA, a non-GAAP financial measure, to analyze our financial results and believe that it is useful to investors, as a supplement to U.S. GAAP measures, in evaluating our ongoing operational performance and enhancing an overall understanding of our past financial performance. We believe that Adjusted EBITDA helps illustrate underlying trends in our business that could otherwise be masked by the effect of the income or expenses that we exclude from Adjusted EBITDA. Furthermore, we use this measure to establish budgets and operational goals for managing our business and evaluating our performance. We also believe that Adjusted EBITDA provides an additional tool for investors to use in comparing our recurring core business operating results over multiple periods with other companies in our industry.

Adjusted EBITDA should not be considered in isolation from, or as a substitute for, financial information prepared in accordance with U.S. GAAP and our calculation of Adjusted EBITDA may differ from that of other

Table of Contents

companies in our industry. We compensate for the inherent limitations associated with using Adjusted EBITDA through disclosure of these limitations, presentation of our financial statements in accordance with U.S. GAAP and reconciliation of Adjusted EBITDA to the most directly comparable U.S. GAAP measure, net loss. We calculate Adjusted EBITDA as net loss before (1) depreciation and amortization, (2) stock-based compensation, (3) Interest income, expense and other, (4) provision for income taxes, and (5) other unusual items that do not directly affect what we consider to be our core operating performance.

The following table shows a reconciliation of net loss to Adjusted EBITDA for the periods presented (in thousands):

	Three Months Ended		Nine Months Ended
	September 30, 2015	September 30, 2014	