A10 Networks, Inc.
Form 10-Q
May 06, 2015

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

Form 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2015
OR

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

For the transition period from to
Commission file number: 001-36343

A10 NETWORKS, INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	20-1446869 (I.R.S. Employer Identification No.)
3 West Plumeria Drive San Jose, California (Address of Principal Executive Offices)	95134 (Zip Code)

(408) 325-8668
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	x	Smaller reporting company	¨

(Do not check if a smaller reporting company)

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

As of May 1, 2015 the number of outstanding shares of the registrant’s common stock, par value $0.00001 per share, was 61,617,622.

A10 Networks, Inc.
Quarterly Report on Form 10-Q
For the Three Months Ended March 31, 2015

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

A10 NETWORKS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited, in thousands, except par value)

	March 31, 2015	December 31, 2014
ASSETS		
Current Assets:		
Cash and cash equivalents	$85,570	$91,905
Accounts receivable, net of allowances of $2,775 and $3,246 as of March 31, 2015 and December 31, 2014	52,762	54,003
Inventory	19,768	20,701
Prepaid expenses and other current assets	4,200	4,732
Total current assets	162,300	171,341
Property and equipment, net	9,951	10,780
Other long-term assets	4,695	4,859
Total Assets	$176,946	$186,980
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$7,989	$8,994
Accrued liabilities	19,850	22,435
Deferred revenue, current	40,155	39,256
Total current liabilities	67,994	70,685
Deferred revenue, non-current	19,505	17,964
Other non-current liabilities	1,557	1,766
Total Liabilities	89,056	90,415
Commitments and contingencies (Note 5)		
Stockholders' Equity:		
Common stock, par value $0.00001 — 500,000 shares authorized as of March 31, 2015 and December 31, 2014; 61,593 and 61,377 shares issued and outstanding as of March 31, 2015 and December 31, 2014	1	1
Additional paid-in capital	283,408	278,349
Accumulated deficit	(195,519)	(181,785)
Total Stockholders' Equity	87,890	96,565
Total Liabilities And Stockholders' Equity	$176,946	$186,980

See accompanying notes to the condensed consolidated financial statements.

A10 NETWORKS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited, in thousands, except per share amounts)

	Three Months Ended March 31,	
	2015	2014
Revenue:		
Products	$30,516	$36,417
Services	13,501	9,328
Total revenue	44,017	45,745
Cost of revenue:		
Products	7,063	7,427
Services	3,723	2,626
Total cost of revenue	10,786	10,053
Gross profit	33,231	35,692
Operating expenses:		
Sales and marketing	24,522	21,563
Research and development	14,309	11,205
General and administrative	7,527	5,363
Litigation expense	445	1,846
Total operating expenses	46,803	39,977
Loss from operations	(13,572)	(4,285)
Other income (expense), net:		
Interest expense	(127)	(587)
Interest income and other income (expense), net	27	(25)
Total other income (expense), net	(100)	(612)
Loss before provision for income taxes	(13,672)	(4,897)
Provision for income taxes	62	205
Net loss	(13,734)	(5,102)
Accretion of redeemable convertible preferred stock dividend	—	(1,150)
Net loss attributable to common stockholders	$(13,734)	$(6,252)
Net loss per share attributable to common stockholders:		
Basic	$(0.22)	$(0.45)
Diluted	$(0.22)	$(0.45)
Weighted-average shares used in computing net loss per share attributable to common stockholders:		
Basic	61,485	13,940
Diluted	61,485	13,940

See accompanying notes to the condensed consolidated financial statements.

A10 NETWORKS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited, in thousands)

	Three Months Ended March 31,	
	2015	2014
Cash flows from operating activities:		
Net loss	$(13,734)	$(5,102)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	2,489	2,247
Stock-based compensation	4,633	1,770
Provision for doubtful accounts and sales returns	144	263
Unrealized foreign exchange gain	(162)	(178)
Changes in operating assets and liabilities:		
Accounts receivable, net	1,311	(1,241)
Inventory	185	(1,785)
Prepaid expenses and other assets	709	(2,277)
Accounts payable	(987)	(341)
Accrued liabilities	(2,639)	870
Deferred revenue	2,438	2,714
Other	115	89
Net cash used in operating activities	(5,498)	(2,971)
Cash flows from investing activities:		
Purchases of property and equipment	(901)	(2,022)
Net cash used in investing activities	(901)	(2,022)
Cash flows from financing activities:		
Proceeds from initial public offering, net of offering costs	—	124,177
Principal payments on revolving credit facility	—	(20,000)
Proceeds from issuance of common stock under employee equity incentive plans, net of repurchases	64	2,248
Other	—	(76)
Net cash provided by financing activities	64	106,349
Net increase (decrease) in cash and cash equivalents	(6,335)	101,356
Cash and cash equivalents—beginning of period	91,905	20,793
Cash and cash equivalents—end of period	$85,570	$122,149
Supplemental Disclosure of Non-Cash Investing and Financing Activities:		
Inventory transfers to property and equipment	$747	$1,416
Costs related to the initial public offering included in accounts payable and accrued liabilities	$—	$1,429
Accretion of Series D redeemable convertible preferred stock	$—	$1,150

See accompanying notes to the condensed consolidated financial statements.

Notes to Condensed Consolidated Financial Statements
(unaudited)

1. Description of Business and Summary of Significant Accounting Policies

Description of Business

A10 Networks, Inc. (together with our subsidiaries, the “Company”, “we”, “our” or “us”) was incorporated in California in 2004 and reincorporated in Delaware in March 2014. We are headquartered in San Jose, California and have wholly-owned subsidiaries throughout the world including Asia and Europe. Our solutions enable enterprises, service providers, Web giants and government organizations to accelerate, secure and optimize the performance of their data center applications and networks. We currently offer three software based advanced application networking solutions. These are Application Delivery Controllers, or ADCs, to optimize data center performance; Carrier Grade Network Address Translation, or CGN, to provide address and protocol translation services for service provider networks; and a Distributed Denial of Service Threat Protection System, or TPS, for network-wide security protection. We deliver these solutions both on optimized hardware appliances and as virtual appliances across our Thunder Series and AX Series product families.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of A10 Networks, Inc., and our wholly owned subsidiaries. All inter-company balances and transactions have been eliminated in consolidation.

We had no comprehensive income (loss) other than our net income (loss), hence our comprehensive income (loss) is the same as the net income (loss) for all periods presented. Pursuant to the accounting guidance provided by Accounting Standard Codification ("ASC") 220 Comprehensive Income, we did not present statements of comprehensive income (loss) for the periods presented.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) and following the requirements of the Securities and Exchange Commission (“SEC”) for interim reporting. As permitted under those rules, certain notes or other financial information that are normally required by U.S. GAAP can be condensed or omitted. These financial statements have been prepared on the same basis as our annual financial statements and, in the opinion of management, reflect all adjustments, consisting only of normal recurring adjustments that are necessary for a fair statement of our financial information. The results of operations for the three months ended March 31, 2015 are not necessarily indicative of the results to be expected for the year ending December 31, 2015 or for any other interim period or for any other future year. The balance sheet as of December 31, 2014 has been derived from audited financial statements at that date but does not include all of the information required by U.S. GAAP for complete financial statements.

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with our audited consolidated financial statements for the year ended December 31, 2014, which are included in the Annual Report on Form 10-K filed with the SEC on March 11, 2015.

Use of Estimates

The preparation of the condensed consolidated financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Those estimates and assumptions affect revenue recognition and deferred revenue, allowance for doubtful accounts, sales return reserve, valuation of inventory, contingencies and litigation, and determination of fair value of stock-based compensation. These estimates are based on information available as of the date of the condensed consolidated financial statements; therefore, actual results could differ from management’s estimates.

Summary of Significant Accounting Policies

There have been no changes to the significant accounting policies described in the 2014 Annual Report on Form 10-K that have had a material impact on our condensed consolidated financial statements and related notes.

Concentration of Credit Risk and Significant Customers

Financial instruments that potentially subject us to concentrations of credit risk consist of cash, cash equivalents and accounts receivable. Our cash and cash equivalents are invested in high-credit quality financial instruments with banks and financial institutions. Management believes that the financial institutions that hold our cash and cash equivalents are financially sound and, accordingly, are subject to minimal credit risk. Such deposits may be in excess of insured limits provided on such deposits.

Our accounts receivable are unsecured and represent amounts due to us based on contractual obligations of our customers. We mitigate credit risk in respect to accounts receivable by performing periodic credit evaluations of our customers to assess the probability of accounts receivable collection based on a number of factors, including past transaction experience with the customer, evaluation of their credit history, limiting the credit extended and review of the invoicing terms of the contract. We generally do not require our customers to provide collateral to support accounts receivable.

Significant customers, including distribution channel partners and direct customers, are those which represent more than 10% of our total revenue for each period presented or our gross accounts receivable balance as of each respective balance sheet date. Revenue from our significant customers as a percentage of our total revenue for the three months ended March 31, 2015 and 2014 are as follows:

	Three Months Ended March 31,	
Customers	2015	2014
Customer A	*	20%
Customer B	*	14%
Customer C	*	11%

* represents less than 10% of total revenue

As of March 31, 2015 and December 31, 2014, no customer accounted for 10% or more of our total gross accounts receivable.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which provides new guidance on the recognition of revenue and states that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This standard will be effective for annual reporting periods beginning after December 15,2016, including interim periods within that reporting period. Early application is not permitted, however, in April 2015, the FASB tentatively proposed a one-year deferral of the effective date. If the proposed deferral is approved, the new standard will become effective for us in the first quarter of fiscal 2018. We are currently evaluating the impact of the adoption of this accounting standard update on our consolidated financial position or results of operations.

There have been no recent accounting pronouncements or changes in accounting pronouncements during the three months ended March 31, 2015, as compared to the recent accounting pronouncements described in our Annual Report on Form 10-K for the year ended December 31, 2014 filed with SEC on March 11, 2015, that are of significance or potential significance to us.

2. Fair Value Measurements

Our financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities. Cash equivalents are stated at amortized cost, which approximates fair value as of the balance sheet dates, due to the short period of time to maturity. Accounts receivable, accounts payable and accrued expenses are stated at their carrying value, which approximates fair value due to the short time to the expected receipt or payment.

Cash and cash equivalents are carried at fair value. Our money market funds are classified within Level I of the fair value hierarchy, as these instruments are valued using quoted market prices. Specifically, we value our investments in money market securities and certificates of deposit based on quoted market prices in active markets. As of March 31, 2015 and December 31, 2014, we had no assets or liabilities classified within Level II or Level III and there were no transfers of instruments between Level I, Level II and Level III regarding fair value measurement.

The following table sets forth the fair value of our financial assets measured on a recurring basis, by level, within the fair value hierarchy (in thousands):

	March 31, 2015		December 31, 2014	
	Level I	Total	Level I	Total
Financial Assets				
Money market funds	$41,054	$41,054	$51,047	$51,047

We did not have realized gains or losses for the three months ended March 31, 2015 and 2014 related to our financial assets.

3. Balance Sheets and Statement of Operations Components

Inventory

Components of inventory as of March 31, 2015 and December 31, 2014 are shown below (in thousands):

	March 31, 2015	December 31, 2014
Raw materials	$7,901	$9,922
Finished goods	11,867	10,779
Total inventory	$19,768	$20,701

Property and Equipment, Net

Components of property and equipment, net as of March 31, 2015 and December 31, 2014 are shown below (in thousands):

	March 31, 2015	December 31, 2014
Equipment	$31,692	$30,486
Software	3,190	3,197
Furniture and fixtures	1,950	860
Leasehold improvements	860	1,780
Construction in progress	340	201
Property and equipment, gross	38,032	36,524
Less: accumulated depreciation and amortization	(28,081)	(25,744)
Total property and equipment, net	$9,951	$10,780

Depreciation and amortization on our property and equipment for the three months ended March 31, 2015 and 2014 was $2.5 million and $2.2 million.

Deferred Revenue

Deferred revenue as of March 31, 2015 and December 31, 2014 consists of the following (in thousands):

	March 31, 2015	December 31, 2014
Deferred revenue:		
Products	$2,513	$2,379
Services	57,147	54,841
Total deferred revenue	59,660	57,220
Less: current portion	(40,155)	(39,256)
Long-term portion	$19,505	$17,964

Accrued Liabilities

Accrued liabilities as of March 31, 2015 and December 31, 2014 consists of the following (in thousands):

	March 31, 2015	December 31, 2014
Accrued compensation and benefits	$13,184	$14,447
Accrued tax liabilities	2,309	2,554
Other	4,357	5,434
Total accrued liabilities	$19,850	$22,435

4. Credit Facility

In September 2013, we entered into a credit agreement with Royal Bank of Canada, JPMorgan Chase Bank, N.A. and Bank of America, N.A. as lenders. The credit agreement provides a three-year $35.0 million revolving credit facility, which includes a maximum $10.0 million letter of credit facility. As of March 31, 2015, we have no outstanding borrowings under this credit facility.

Our obligations under the credit agreement are secured by a security interest on substantially all of our assets, including our intellectual property. The credit agreement contains customary financial and non-financial covenants, and are described in Note 4, Credit Facility of the Notes to Consolidated Financial Statements of our Annual Report on Form 10-K for the year ended December 31, 2014 filed with the SEC on March 11, 2015. We were in compliance with all financial and nonfinancial covenants under the revolving credit facility as of March 31, 2015.

At our option, the revolving credit facility bears interest at a rate per annum based on either (i) an alternate base rate plus a margin ranging from 1.75% to 2.50% depending on our total leverage ratio, or (ii) the London interbank offered rate, or LIBOR, based on one, two, three or six month interest periods plus a margin ranging from 2.75% to 3.50% depending on our total leverage ratio. The alternate base rate is equal to the greatest of (i) the Royal Bank of Canada's prime rate, (ii) the federal funds rate plus a margin equal to 0.50% and (iii) the Eurodollar rate for a one month interest period plus a margin equal to 1.00%.

In addition, we incurred $1.0 million of debt issuance costs that were directly attributable to the issuance of this revolving credit facility which will be amortized to interest expense over the three-year term of this credit facility. As of March 31, 2015, the unamortized debt issuance costs of $0.4 million were included within other long-term assets in our Condensed Consolidated Balance Sheets. We are also required to pay quarterly facility fees of 0.45% per annum on the average daily unused portion of the revolving credit facility.

5. Commitments and Contingencies

Legal Proceedings

From time to time, we may be party or subject to various legal proceedings and claims, either asserted or unasserted, which arise in the ordinary course of business, including proceedings and claims that relate to intellectual property matters. Some of these proceedings involve claims that are subject to substantial uncertainties and unascertainable damages. Accordingly, except as disclosed, we have not established reserves or ranges of possible loss related to these proceedings, as at this time in the proceedings, if any, the matters do not relate to a probable loss and/or amounts cannot be reasonably estimated.

In November 2013, Parallel Networks, LLC ("Parallel Networks"), which we believe is a non-practicing patent holding company, filed a lawsuit against us in the United States District Court for the District of Delaware. In the lawsuit, Parallel Networks alleges that our AX and Thunder series products infringe two of their U.S. patents. Parallel Networks is seeking injunctive relief, damages and attorneys' fees and costs. Parallel Networks has asserted similar claims against a number of our competitors. The separate trials for each defendant in these related actions are set to commence in June 2016 in accordance with an order to be set forth in a trial sequencing conference. We intend to vigorously defend the lawsuit. We are unable to reasonably estimate a possible loss or range of possible loss if any, in regards to this matter; therefore, no accrued litigation expense has been recorded in the accompanying Condensed Consolidated Balance Sheets.

On January 29, 2015, the Company, the members of our Board of Directors, our Chief Financial Officer, and the underwriters of our March 21, 2014, initial public offering were named as defendants in a putative class action lawsuit filed in the Superior Court of the State of California, County of Santa Clara, captioned City of Warren Police and Fire Retirement System v. A10 Networks, Inc., et al., 1-15-CV-276207. Several substantially identical lawsuits were subsequently filed in the same court, bringing the same claims against the same defendants, captioned Arkansas Teacher Retirement System v. A10 Networks, Inc., et al., 1-15-CV-278575 (filed March 25, 2015) and Kaveny v. A10 Networks, Inc., et al., 1-15-CV-279006 (filed April 6, 2015). The complaints seek to allege violations of the federal Securities Act of 1933 on behalf of a putative class consisting of purchasers of our common stock pursuant or traceable to the registration statement and prospectus for the initial public offering, and seek unspecified compensatory damages and other relief. We intend to vigorously defend these lawsuits. Based on information currently available, we are unable to reasonably estimate a possible loss or range of possible loss, if any, in regards to these lawsuits; therefore, no accrued liabilities has been recorded in the accompanying Condensed Consolidated Balance Sheets.

Lease Obligations and Other Commitments

Commencing in 2012, we entered into an equipment financing arrangement with a financial institution whereby the financial institution purchases and leases to us, equipment (primarily computer and network-related) for use in our business. Amounts financed under the leases are accounted for as capital leases. We financed $0.8 million under the arrangement in 2012, which was fully repaid by December 2014. In March 2015, we entered into an agreement to lease an additional $0.3 million of equipment under this financing arrangement. The anticipated delivery date of the leased equipment is in the second quarter of 2015. As of March 31, 2015 and December 31, 2014, we had no outstanding borrowings under this financing arrangement.

We lease various operating spaces in the United States, Asia, and Europe under noncancelable operating lease arrangements that expire on various dates through February 2020. These arrangements require us to pay certain operating expenses, such as taxes, repairs, and insurance and contain renewal and escalation clauses. We recognize rent expense under these arrangements on a straight-line basis over the term of the lease.

We have entered into agreements with some of our customers and channel partners that contain indemnification provisions in the event of claims alleging that our products infringe the intellectual property rights of a third party. Other guarantees or indemnification arrangements include guarantees of product and service performance and standby letters of credit for lease facilities and corporate credit cards. We have not recorded a liability related to these indemnification and guarantee provisions and our guarantees and indemnification arrangements have not had any significant impact on our consolidated financial statements to date.

6. Equity Award Plans

Equity Incentive Plans

2014 Equity Incentive Plan

Our 2014 Equity Incentive Plan (the "2014 Plan") was adopted by our Board of Directors and approved by our stockholders in March 2014. The 2014 Plan provides for the granting of stock options, restricted stock awards, restricted stock units, stock appreciation rights, performance units and performance shares to our employees, directors and consultants.

As of December 31, 2014, we had 1,343,743 shares available for future grant. Pursuant to the provisions of the 2014 Plan, on the first day of each fiscal year, starting with January 1, 2015, the number of shares in the reserve will increase by the least of (i) 8,000,000 shares, (ii) 5% of the outstanding shares of common stock on the last day of our immediately preceding fiscal year, or (iii) such other amount as determined by our Board of Directors. In January 2015, we increased common stock reserved for issuance by 3,078,645 shares in accordance with the provisions of the 2014 Plan. During the three months ended March 31, 2015, we granted 148,500 stock options and 376,280 RSUs under the 2014 Plan to our employees and consultants. As of March 31, 2015, we have 4,270,990 shares available for future grant.

2014 Employee Stock Purchase Plan

The 2014 Employee Stock Purchase Plan (the "2014 Purchase Plan") was adopted by our Board of Directors and approved by our stockholders in March 2014.

As of December 31, 2014, we had 1,031,316 shares available for future purchase. Under the provisions of the 2014 Purchase Plan, on the first day of each fiscal year, starting with January 1, 2015, the number of shares in the reserve will increase by the lesser of (i) 3,500,000 shares, (ii) 1% of the outstanding shares of our common stock on the last day of the immediately preceding fiscal year, or (iii) such other amount as determined by our Board of Directors or other committee administering the 2014 Purchase Plan. In January 2015, we increased common shares reserved for future purchase by 615,729 shares in accordance with the provision of the 2014 Purchase Plan. There was no purchases under the 2014 Purchase Plan during the three months ended March 31, 2015. As of March 31, 2015, we have 1,647,045 shares available for future purchase.

Stock-based Compensation

Stock-based compensation is based on the estimated fair value of awards, net of estimated forfeitures, and recognized over the requisite service period. The following is a summary of stock-based compensation for stock-based awards granted under the 2014 Plan, the 2008 Plan, and employee stock purchases under the 2014 Purchase Plan recognized during the three months ended March 31, 2015 and 2014 (in thousands):

	Three Months Ended March 31,	
	2015	2014
Stock-based compensation by type of award:		
Stock options	$1,477	$1,685
Restricted stock units	1,934	—
Employee stock purchase plan	1,222	85
Total stock-based compensation	$4,633	$1,770

Stock-based compensation by category of expense:		
Cost of revenue	$471	$85
Sales and marketing	2,066	884
Research and development	1,585	463
General and administrative	511	338
	$4,633	$1,770

10

At March 31, 2015, we had $30.7 million of unrecognized stock-based compensation expense, net of estimated forfeitures, related to stock options, unvested restricted stock units and 2014 Stock Purchase Plan grants which will be recognized over a weighted-average period of 2.6 years.

Determination of Fair Value

We use the Black-Scholes option pricing model to determine the grant date fair value of stock options and stock purchases and recognize stock-based compensation expense on a straight-line basis over the requisite service period.

The determination of the fair value on the date of grant is affected by the estimated underlying common stock price, as well as assumptions regarding a number of complex and subjective variables. These variables include expected stock price volatility over the term of the awards, actual and projected employee stock option exercise behaviors, risk-free interest rates, and expected dividends.

The fair value of each grant of stock options was determined using the Black-Scholes option pricing model and assumptions discussed below. Each of these inputs is subjective and generally requires significant judgment to determine.

• Expected Term. We estimate the expected life of options based on an analysis of our historical experience of employee exercise and post-vesting termination behavior considered in relation to the contractual life of the option. The expected term for the 2014 Purchase Plan is based on the term of the purchase period.

• Risk-Free Interest Rate. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant for zero coupon U.S. Treasury notes with maturities approximately equal to the expected terms of stock options and shares to be issued under the 2014 Purchase Plan.

• Expected Volatility. Due to the limited trading history of our own common stock, we determined the share price volatility factor based on a combination of the historical volatility of our own common stock and the historical volatility of our peer group.

• Dividend Rate. The expected dividend was assumed to be zero as we have never paid dividends and have no current plans to do so.

Stock Option Activity

The following table summarizes our stock option activity and related information as of and for the three months ended March 31, 2015 (in thousands, except for years and per share amounts):

	Number of Shares Underlying Outstanding Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding as of December 31, 2014	11,084	$ 5.18	7.9	
Granted	149	$ 4.67		
Exercised	(166)	$ 1.59		
Canceled	(415)	$ 7.32		
Outstanding as of March 31, 2015	10,652	$ 5.15	7.6	$7,521
Vested and expected to vest as of March 31, 2015	10,091	$ 5.10	7.5	$7,518
Vested and exercisable as of March 31, 2015	5,118	$ 3.97	6.2	$7,368

The aggregate intrinsic value represents the difference between the closing stock price of our common stock on March 31, 2015 compared to the exercise price of the outstanding in-the-money options.

The following table provides information pertaining to our stock options for the three months ended March 31, 2015 and 2014 (in thousands, except weighted-average fair values):

	Three Months Ended March 31,	
	2015	2014
Total fair value of options granted	$305	$7,071
Weighted average fair value of options granted	$2.05	$5.97
Intrinsic value of options exercised	$537	$6,692

The estimated grant-date fair value of our equity-based awards issued to employees was calculated using the Black-Scholes option-pricing model, based on the following assumptions:

	Three Months Ended March 31,	
	2015	2014
Expected term (in years)	4.8	5.5
Risk-free interest rate	1.41%	1.73%
Expected volatility	51%	47%
Dividend rate	—%	—%

Restricted Stock Units Activity

We have granted time-based restricted stock units ("RSU") to our employees, directors and consultants and market performance-based restricted stock units ("MSU") to certain executive officers.

Time-based Restricted Stock Units

A summary of RSU activities for the three months ended March 31, 2015, is as follows (in thousands, except years and per share amounts):

	Number of Shares	Weighted Average Grant Date Fair Value	Weighted Average Remaining Contractual Life	Aggregated Intrinsic Value
Outstanding as of December 31, 2014	2,388	$8.97		
Granted	376	$4.61		
Released	(18)	$10.58		
Canceled	(168)	$9.27		
Outstanding as of March 31, 2015	2,578	$8.30	1.5	$11,161

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (calculated by multiplying our closing stock price on the last trading day of the period by the number of unvested RSUs) that would have been received by the unit holders had all RSUs been vested and released on March 31, 2015. This amount will fluctuate based on the fair market value of our stock.

Market Performance-based Restricted Stock Units

We granted MSUs covering 540,000 shares of our common stock to our executive officers during 2014, all of which were outstanding as of March 31, 2015. These MSUs will vest if the closing price of our common stock remains above certain predetermined target prices for 20 consecutive trading days within a 4-year period following the award's grant date, subject to continued service by the award holder.

The total aggregate intrinsic value for the MSUs granted was $2.4 million, which represents the total pre-tax intrinsic value (calculated by multiplying our closing stock price on the last trading day of period by the number of unvested MSUs) that would have been received by the award holders had all MSUs vested and been released on March 31, 2015. This amount will fluctuate based on the fair market value of our stock. No MSUs were vested or released during the three months ended March 31, 2015.

Employee Stock Purchase Plan

The fair value of the option component of the 2014 Purchase Plan shares was estimated at the grant date using the Black-Scholes option pricing model with the following weighted average assumptions:

	Three Months Ended March 31,	
	2015	2014
Expected term (in years)	n/a	1.42
Risk-free interest rate	n/a	2.14%
Expected volatility	n/a	31.00%
Dividend rate	n/a	—%

* There were no stock purchase rights granted under the 2014 Purchase Plan during the three months ended March 31, 2015.

7. Net Income Per Share Available (Loss Attributable) To Common Stockholders

The following table sets forth the computation of our basic and diluted net loss per share attributable to common stockholders (in thousands, except per share data):

	Three Months Ended March 31,	
	2015	2014
Basic and diluted net loss per share attributable to common stockholders		
Numerator:		
Net loss attributable to common stockholders	$(13,734)	$(6,252)
Denominator:		
Weighted-average shares outstanding - basic	61,485	13,940
Effect of dilutive potential common shares from stock options and restricted stock units	—	—
Weighted-average shares outstanding - diluted	61,485	13,940
Net loss per share attributable to common stockholders:		
Basic and diluted	$(0.22)	$(0.45)

The following weighted average outstanding shares of common stock equivalents were excluded from the computation of diluted net loss per share attributable to common stockholders for the periods presented because including them would have been antidilutive (in thousands):

	Three Months Ended March 31,	
	2015	2014
Stock options, restricted stock units and employee stock purchase plan	11,318	9,936
Common stock subject to repurchase	117	342
	11,435	10,278

8. Income Taxes

We recorded income tax expense of $0.1 million and $0.2 million for the three months ended March 31, 2015 and 2014, which was primarily comprised of foreign taxes. Income taxes are accounted for under the asset and liability method.

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the carrying amounts of existing assets and liabilities in the financial statements and their respective tax bases using tax rates expected to be in effect during the years in which the basis differences reverse.

We believe it is more likely than not that our federal and state net deferred tax assets will not be fully realized. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of a deferred tax asset will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. A valuation allowance is recorded for loss carryforwards and other deferred tax assets where it is more likely than not that such deferred tax assets will not be realized. Accordingly, we continue to maintain a valuation allowance against all of our net deferred tax assets as of March 31, 2015. Due to historic losses in the U.S., we have a full valuation allowance on the U.S. federal and state deferred tax assets. We will continue to maintain a full valuation allowance against our net federal, state and certain foreign deferred tax assets until there is sufficient evidence to support recoverability of our deferred tax assets.

We had $2.3 million and $2.2 million of unrecognized tax benefits as of March 31, 2015 and December 31, 2014. We do not anticipate a material change to our unrecognized tax benefits over the next twelve months. Unrecognized tax benefits may change during the next twelve months for items that arise in the ordinary course of business.

Accrued interest and penalties related to unrecognized tax benefits are recognized as part of our income tax provision in the Condensed Consolidated Statements of Operations. All tax years remain open and are subject to future examinations by federal, state and foreign tax authorities. We are not under examination in any jurisdiction.

9. Segment Information

Our chief operating decision maker is our Chief Executive Officer who reviews financial information presented on a consolidated basis, accompanied by disaggregated information about revenue by geographic region for purposes of allocating resources and evaluating financial performance. Accordingly, we have a single reportable segment and operating segment structure.

The following table represents revenue by geographic areas based on customers' location, as determined by their ship to addresses (in thousands):

	Three Months Ended March 31,	
	2015	2014
United States	$22,858	$18,212
Japan	8,840	17,305
Asia Pacific, excluding Japan	4,586	4,304
EMEA	6,225	4,140
Other	1,508	1,784
Total revenue	$44,017	$45,745

No other country outside of the United States and Japan comprised 10% or greater of our revenue for the three months ended March 31, 2015 and 2014.

Geographical information relating to our long-lived assets which include property and equipment, net and intangible assets, net as of March 31, 2015 and December 31, 2014 was as follows (in thousands):

	March 31, 2015	December 31, 2014
United States	$9,076	$9,702
Japan	179	247
Asia Pacific, excluding Japan	1,564	1,724
EMEA	103	104

Total property and equipment, net and intangible assets, net	$10,922	$11,777

10. Related-Party Transactions

An affiliate of one of our significant stockholders is also acting as a reseller of our products. During the three months ended March 31, 2015 and 2014, we recognized $1.4 million and $0.6 million total revenue from this reseller. We had gross accounts receivable of $0.8 million and $0.4 million from this reseller as of March 31, 2015 and December 31, 2014.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q. The following discussion and analysis contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The words “believe,” “may,” “will,” “potentially,” “estimate,” “continue,” “anticipate,” “intend,” “could,” “would,” “project,” “plan” “expect,” and similar expressions that conve uncertainty of future events or outcomes are intended to identify forward-looking statements.

These forward-looking statements include, but are not limited to, statements concerning the following:

- our ability to maintain an adequate rate of revenue growth;
- our business plan and our ability to effectively manage our growth;
- costs associated with defending intellectual property infringement and other claims;
- our ability to attract and retain end-customers;
- our ability to further penetrate our existing customer base;
- our ability to displace existing products in established markets;
- our ability to expand our leadership position in next-generation application delivery and server load balancing solutions;
- our ability to timely and effectively scale and adapt our existing technology;
- our ability to innovate new products and bring them to market in a timely manner;
- our ability to expand internationally;
- the effects of increased competition in our market and our ability to compete effectively;
- the effects of seasonal trends on our results of operations;
- our expectations concerning relationships with third parties;
- the attraction and retention of qualified employees and key personnel;
- our ability to maintain, protect, and enhance our brand and intellectual property; and
- future acquisitions of or investments in complementary companies, products, services or technologies.

These forward-looking statements are subject to a number of risks, uncertainties, and assumptions, including those described in “Risk Factors” and elsewhere in this Quarterly Report on Form 10-Q. Moreover, we operate in a very competitive and rapidly changing environment, and new risks emerge from time to time. It is not possible for our management to predict all risks, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements we may make. In light of these risks, uncertainties, and assumptions, the forward-looking events and circumstances discussed in this Quarterly Report on Form 10-Q may not occur and actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements.

You should not rely upon forward-looking statements as predictions of future events. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee that the future results, levels of activity, performance or events and circumstances reflected in the forward-looking statements will be achieved or occur. Moreover, neither we nor any other person assumes responsibility for the accuracy and completeness of the forward-looking statements. We undertake no obligation to update publicly any forward-looking statements for any reason after the date of this Quarterly Report on Form 10-Q to conform these statements to actual results or to changes in our expectations, except as required by law.

Overview

We are a leading provider of application networking technologies. Our solutions enable service providers, enterprises,Web giants and government organizations to accelerate, secure and optimize the performance of their data center applications and networks. Our products are built on our Advanced Core Operating System ("ACOS") platform of advanced network technologies, which is designed to enable our products to deliver substantially greater performance and security relative to prior generation application networking products. Our software based ACOS architecture also provides the flexibility that enables us to expand our business to offer additional products to solve a growing array of networking and security challenges arising from increased Internet cloud and mobile computing.

We currently offer three software based advanced application networking solutions. These are Application Delivery Controllers ("ADCs") to optimize data center performance, Carrier Grade Network Address Translation ("CGN") to provide address and protocol translation services for service provider networks, and a Distributed Denial of Service Threat Protection System ("TPS") for network-wide security protection. We deliver these solutions both on optimized hardware appliances and as virtual appliances across our Thunder Series and AX Series product families.

We derive revenue from sales of products and related support services. Product revenues are generated primarily by sales of hardware appliances with perpetual licenses to our embedded software solutions. We generate services revenue primarily from sales of maintenance and support contracts. Our end-customers predominantly purchase maintenance and support in conjunction with purchases of our products.

We sell our products globally to service providers and enterprises that depend on data center applications and networks to generate revenue and manage operations efficiently. Our end-customers operate in a variety of industries, including telecommunications, technology, industrial, retail, financial and education. Since inception, our customer base has grown rapidly. As of March 31, 2015, we had sold products to approximately 4,100 customers across 71 countries.

We sell substantially all of our solutions through our high-touch sales organization as well as distribution channel partners, including distributors, value added resellers and system integrators, and fulfill nearly all orders globally through such partners. We believe this sales approach allows us to obtain the benefits of channel distribution, such as expanding our market coverage, while still maintaining face-to-face relationships with our end-customers. We outsource the manufacturing of our hardware products to original design manufacturers. We perform quality assurance and testing at our San Jose, California facilities, as well as at our manufacturers’ locations. We warehouse and deliver out of our San Jose warehouse most product destined for delivery in the Americas. We outsource warehousing and delivery to third-party logistics providers for most product destined for other regions.

During the first quarter of 2015, 52% of our total revenue was generated from the United States, 20% from Japan, and 28% from other geographical regions. During the first quarter of 2014, 40% of our total revenue was generated from the United States, 38% from Japan and 22% from other geographical regions. During the first quarters of 2015 and 2014, our enterprise customers accounted for 57% and 44% of our total revenue. During the first quarters of 2015 and 2014, our service provider customers accounted for 43% and 56% of our total revenue.

As a result of the nature of our target market and the current stage of our development, a substantial portion of our revenue comes from a limited number of large end-customers, including service providers, in any period. During the first quarters of 2015 and 2014, purchases from our ten largest end-customers accounted for approximately 42% and 54% of our total revenue. Sales to these large end-customers have typically been characterized by large but irregular purchases with long sales cycles. The timing of these purchases and the delivery of the purchased products is difficult to predict. As a consequence, any acceleration or delay in anticipated product purchases, by or deliveries to, our largest end customers could materially impact our revenue and operating results in any quarterly period. This may cause our quarterly revenue and operating results to fluctuate from quarter to quarter and make them difficult to predict.

We intend to continue to invest for long-term growth. We have invested in and expect to continue to invest in our product development efforts to deliver new products and additional features in our current products to address customer needs. In addition, we expect to continue to expand our global sales and marketing organizations, expand our distribution channel partner programs and increase awareness of our solutions on a global basis. Additionally we will be investing in general and administrative resources to meet the requirements to operate as a public company. Our investments in growth in these areas may affect short-term profitability.

Results of Operations

The following table provides a summary of our Condensed Consolidated Statements of Operations for the three months ended March 31, 2015 and 2014 as derived from our condensed consolidated financial statements included in Part I Financial Information in this Quarterly Report on Form 10-Q (in thousands, except for percentages).

	Three Months Ended March 31,					
	2015		2014		Increase (Decrease)	
	Amount	Percent of Total Revenue	Amount	Percent of Total Revenue	Amount	Percent
Revenue:						
Products	$30,516	69.3 %	$36,417	79.6 %	$(5,901)	(16.2)%
Services	13,501	30.7	9,328	20.4	4,173	44.7
Total revenue	44,017	100.0	45,745	100.0	(1,728)	(3.8)
Cost of revenue:						
Products	7,063	16.0	7,427	16.2	(364)	(4.9)
Services	3,723	8.5	2,626	5.7	1,097	41.8
Total cost of revenue	10,786	24.5	10,053	22.0	733	7.3
Gross profit	33,231	75.5	35,692	78.0	(2,461)	(6.9)
Operating expenses:						
Sales and marketing	24,522	55.7	21,563	47.1	2,959	13.7
Research and development	14,309	32.5	11,205	24.5	3,104	27.7
General and administrative	7,527	17.1	5,363	11.7	2,164	40.4
Litigation expense	445	1.0	1,846	4.0	(1,401)	(75.9)
Total operating expenses	46,803	106.3	39,977	87.4	6,826	17.1
Loss from operations	(13,572)	(30.8)	(4,285)	(9.4)	(9,287)	(216.7)
Other income (expense), net:						
Interest expense	(127)	(0.3)	(587)	(1.3)	460	78.4
Interest income and other income (expense), net	27	0.1	(25)	(0.1)	52	208.0
Total other income (expense), net	(100)	(0.2)	(612)	(1.3)	512	83.7
Loss before provision for income taxes	(13,672)	(31.1)	(4,897)	(10.7)	(8,775)	(179.2)
Provision for income taxes	62	0.1	205	0.4	(143)	(69.8)
Net loss	$(13,734)	(31.2)%	$(5,102)	(11.2)%	$(8,632)	(169.2)%

Revenue

Our products revenue primarily consists of revenue from sales of our hardware appliances upon which our software is installed. Such software includes our ACOS software platform plus one of our ADC, CGN or TPS solutions. Purchase of a hardware appliance includes a perpetual license to the included software. We recognize products revenue at the time of shipment, provided that all other revenue recognition criteria have been met. As a percentage of revenue, our products revenue may vary from quarter to quarter based on, among other things, the timing of orders and delivery of products, cyclicality and seasonality, changes in currency exchange rates and the impact of significant transactions with unique terms and conditions.

We generate services revenue from sales of post contract support, or PCS, which is bundled with sales of products and professional services. We offer tiered PCS services under renewable, fee-based PCS contracts, primarily including technical support, hardware repair and replacement parts, and software upgrades on a when-and-if-released basis. We recognize services revenue ratably over the term of the PCS contract, which is typically one year, but can be up to five years. We expect ourservices revenue to increase in absolute dollars as we expand our installed base.

A summary of our total revenue for the three months ended March 31, 2015 and 2014 is as follows (in thousands, except for percentages):

	Three Months Ended March 31,		Increase (Decrease)	
	2015	2014	Amount	Percent
Revenue:				
Products	$30,516	$36,417	$(5,901)	(16.2)%
Services	13,501	9,328	4,173	44.7
Total revenue	$44,017	$45,745	$(1,728)	(3.8)%
Revenue by geographic location:				
United States	$22,858	$18,212	$4,646	25.5%
Japan	8,840	17,305	(8,465)	(48.9)
Asia Pacific, excluding Japan	4,586	4,304	282	6.6
EMEA	6,225	4,140	2,085	50.4
Other	1,508	1,784	(276)	(15.5)
Total revenue	$44,017	$45,745	$(1,728)	(3.8)%

Total revenue decreased by $1.7 million in the first quarter of 2015 compared to the first quarter of 2014, which consisted of a $5.9 million decrease in products revenue partially offset by a $4.2 million increase in services revenue. Revenue from enterprise customers increased 26% compared to the first quarter of 2014. Revenue from service provider customers decreased 26% compared to the first quarter in 2014.

Products revenue decreased $5.9 million, or 16.2% in the first quarter of 2015 compared to the first quarter in 2014 which is primarily attributable to a slowdown in demand for our products from service providers.

Services revenue increased $4.2 million or 44.7% in the first quarter of 2015 compared to the same period in 2014 primarily attributable to the increase in PCS sales in connection with our increasing installed customer base as well as increases in our professional services revenue. Over 95% of our end-customers purchase one of our maintenance service products when purchasing our hardware products. During the first quarter of 2015, services revenue recognized from contracts existing prior to 2015 grew by 45% as compared to services revenue related to contracts existing prior to 2014.

During the first quarter of 2015, 52%, or $22.9 million of total revenue was generated from the United States, which represents a 26% growth compared to the first quarter of 2014. This increase was primarily attributable to strong demand for our products from North America enterprise customers and higher PCS sales in connection with our increased installed customer base. During the first quarter of 2015, 20%, or $8.8 million of total revenue was generated from Japan, a 49% decrease compared to the first quarter of 2014. In the first quarter of 2014, our products revenue from Japan was positively impacted by a higher backlog entering the quarter that resulted from strong demand for our products in Japan in the fourth quarter of 2013. We continue to see growth in our EMEA and Asia Pacific regions, excluding Japan, with total revenue increasing by 50% to $6.2 million and 7% to $4.6 million in the first quarter of 2015 compared to the first quarter of 2014 primarily due to our efforts to expand our presence in these regions.

Cost of Revenue, Gross Profit and Gross Margin

Cost of revenue

A summary of our cost of revenue for the three months ended March 31, 2015 and 2014 is as follows (in thousands, except for percentages):

	Three Months Ended March 31,		Increase (Decrease)	
	2015	2014	Amount	Percent
Cost of revenue:				
Products	$7,063	$7,427	$(364)	(4.9)%
Services	3,723	2,626	1,097	41.8
Total cost of revenue	$10,786	$10,053	$733	7.3%

Gross Margin

Gross margin varies from period to period due to a variety of factors. These may include the mix of revenue from each of our regions, the mix of our products sold within a period, discounts provided to customers, discounts on early sales of new products to gain market penetration, inventory write-downs and international currency exchange rates.

Our sales are generally denominated in U.S. dollars, however, in Japan they are denominated in the Japanese yen. Changes in the exchange rates between the U.S. dollar and Japanese yen will therefore affect our revenue and gross margin. Any of the factors noted above can generate either a positive or negative impact on gross margin as compared to another period. Although our gross margin for the first quarter of 2015 decreased compared to the same period in the prior year, we expect our gross margin generally to be consistent with our historical average in the future.

A summary of gross profit and gross margin for the three months ended March 31, 2015 and 2014 is as follows (in thousands, except for gross margins and percentages):

	Three Months Ended March 31,				Increase (Decrease)	
	2015		2014			
	Amount	Gross Margin	Amount	Gross Margin	Amount	Gross Margin
Gross profit:						
Products	$23,453	76.9%	$28,990	79.6%	$(5,537)	(2.8)%
Services	9,778	72.4	6,702	71.8	3,076	0.6
Total gross profit	$33,231	75.5%	$35,692	78.0%	$(2,461)	(2.5)%

Products gross margin decreased 2.8 percentage points in the first quarter of 2015 compared to the first quarter of 2014 primarily due to an unfavorable shift in our geographical sales mix. We experienced lower sales volumes from geographic regions with generally higher gross margins in the first quarter of 2015 compared to the first quarter of 2014, which negatively impacted our gross margin in the first quarter of 2015.

Services gross margin increased 0.6 percentage points in the first quarter of 2015 compared to the first quarter of 2014, as a result of growth in services revenue and partially offset by the impact of increases in cost of services. Our services revenue recognized from our installed base with existing contracts prior to 2015 grew by 45% compared to revenue generated during the first quarter of 2014. The increase in cost of services was primarily a result of our investment to expand our services and support teams in anticipation of future growth in our installed base. We increased our average support, training and professional services headcount by 26% during the first quarter of 2015 as compared to the first quarter of 2014.

Operating Expenses

Our operating expenses consist of sales and marketing, research and development, general and administrative and litigation. The largest component of our operating expenses is personnel costs which consist of wages, benefits, bonuses, and, with respect to sales and marketing expenses, sales commissions. Personnel costs also include stock-based compensation and travel expenses.

A summary of our operating expenses for the three months ended March 31, 2015 and 2014 is as follows (in thousands, except for percentages):

	Three Months Ended March 31,		Increase (Decrease)	
	2015	2014	Amount	Percent
Operating expenses:				
Sales and marketing	$24,522	$21,563	$2,959	13.7 %
Research and development	14,309	11,205	3,104	27.7
General and administrative	7,527	5,363	2,164	40.4
Litigation expense	445	1,846	(1,401)	(75.9)
Total operating expenses	$46,803	$39,977	$6,826	17.1 %

Sales and Marketing

Sales and marketing expenses are our largest functional category of total operating expense. These expenses primarily consist of personnel costs related to our employees engaged in sales and marketing activities. Sales and marketing expenses also include the cost of marketing programs, trade shows, consulting services, promotional materials, demonstration equipment, depreciation and certain allocated facilities and information technology infrastructure costs.

Sales and marketing expenses increased $3.0 million or 13.7% in the first quarter of 2015 compared to the first quarter of 2014 primarily attributable to a $2.3 million increase in personnel and related costs, which includes a $1.2 million increase in stock-based compensation and a $1.0 million increase in sales commissions. Our average sales and marketing headcount grew 10% during the first quarter of 2015 compared to the same period in 2014. Additionally, company meeting related costs increased $0.3 million in the first quarter of 2015 compared to the first quarter of 2014 as result of our annual sales kick-off meeting held in January 2015. Depreciation expense and allocated facilities and information technology infrastructure costs also increased by $0.3 million as a result of higher headcount and increased depreciation expense on our evaluation equipment.

We expect our sales and marketing expenses to continue to increase in absolute dollars for the remainder of 2015 as we increase the size of our sales and marketing organization and as we increase our sales presence in existing countries and expand into new countries.

Research and Development

Research and development efforts are focused on new product development and on developing additional functionality
for our existing products. These expenses consist of personnel costs, and to a lesser extent, professional services, prototype materials, depreciation and certain allocated facilities and information technology infrastructure costs. We expense research and development costs as incurred.

Research and development expenses increased $3.1 million in the first quarter of 2015 compared to the first quarter of 2014 primarily attributed to a $3.6 million increase in personnel related costs, which includes a $1.1 million increase in stock-based compensation. The increase in personnel related costs during the first quarter of 2015 compared to the first quarter of 2014 was also attributable to higher salaries and benefits as a result of merit increases, an increase in discretionary bonuses as well as a 4% increase in our average research and development headcount. The increase in personnel related research and development expense was partially offset by a $0.5 million decrease in professional services fees due to lower product certification related activities in the first quarter of 2015 compared to the same period in 2014.

We expect our research and development expenses to increase in absolute dollars for the remainder of 2015 as we continue to develop new products and enhance our existing products.

General and Administrative

General and administrative expenses consist primarily of personnel costs, professional services fees and facility costs. General and administrative personnel costs include executive, finance, human resources, information technology, facility and legal (excluding litigation) related expenses. Professional fees consist primarily of fees for outside accounting, tax, legal, recruiting and other administrative services.

General and administrative expenses increased $2.2 million from the first quarter of 2015 compared to the first quarter of 2014 primarily attributed to a $0.9 million increase in personnel related costs which includes a $0.2 million increase in stock-based compensation, a $0.8 million increase in professional services costs and a $0.5 million increase in bad debt expense. The increase in personnel related costs was a result of a 34% increase in average general and administrative headcount during the first quarter of 2015 compared to the first quarter of 2014. The increase in professional services fees was primarily related to increased general legal and consultant fees in connection with scaling our organization to support increased business activity and costs associated with being a public company.

We expect our general and administrative expenses to increase slightly in the remainder of 2015.

Litigation Expense

Litigation expense is comprised of legal expenses incurred related to litigation and, if applicable, charges for litigation reserves. Litigation expenses consist of professional fees incurred in defending ourselves against litigation matters and are expensed as incurred when professional services are provided. The litigation reserve, if any, consists of accruals we make related to estimated losses in pending legal proceedings. Litigation reserves, if any, are adjusted as we change our estimates or make payments in damages or settlements.

Litigation expense decreased $1.4 million for the first quarter of 2015 compared to the first quarter of 2014 primarily attributable to a reduction in litigation related activities following the settlement of the litigation with Radware in August 2014.

Interest Expense

Interest expense decreased by $0.5 million in the first quarter of 2015 compared to the first quarter of 2014, primarily due to lower borrowing related activities in the first quarter of 2015 compared to the same period in 2014. During the first quarter of 2014, we recorded a $0.3 million contingent payment due to a lender upon completion of our initial public offering and $0.2 million of interest expense related to our revolving credit facility. We completed our initial public offering and repaid the outstanding balance under our revolving credit facility in March 2014.

Provision for Income Taxes

We recorded an income tax provision of $0.1 million and $0.2 million in the first quarters of 2015 and 2014 which is primarily the result of taxes in foreign jurisdictions. We maintain a valuation allowance on federal and state deferred tax assets as we do not believe it is more likely than not that our deferred tax assets will be realized. We will continue to maintain a full valuation allowance on our deferred tax assets until there is sufficient evidence to support the reversal of all or some portion of this allowance.

Liquidity and Capital Resources

As of March 31, 2015, we had cash and cash equivalents of $85.6 million, including $3.2 million held outside the United States in our foreign subsidiaries. We currently do not have any plans to repatriate our earnings from our foreign operations. As of March 31, 2015, we had working capital of $94.3 million, an accumulated deficit of $195.5

million and total stockholders' equity of $87.9 million.

We plan to continue to invest for long-term growth and anticipate our investment will continue to increase in absolute dollars. We believe that our existing cash and cash equivalents and other available financial resources will be sufficient to meet our anticipated cash needs for at least the next 12 months. Our future capital requirements will depend on many factors, including our growth rate, the expansion of sales and marketing activities, the timing and extent of spending to support development efforts, the introduction of new and enhanced product and service offerings and the continuing market acceptance of our products. In the event that additional financing is required from outside sources, we may not be able to raise such financing on terms acceptable to us or at all. If we are unable to raise additional capital when desired, our business, operating results and financial condition could be adversely affected.

In addition, as described in the section "Legal Proceedings" we are currently involved in ongoing litigation. Any adverse settlements or judgments in any litigation could have a material adverse impact on our results of operations, cash balances and cash flows in the period in which such events occur.

Credit Agreement

In September 2013, we entered into a credit agreement with Royal Bank of Canada, acting as administrative agent and lender, and JPMorgan Chase Bank, N.A. and Bank of America, N.A. as lenders. The credit agreement provides a three-year $35.0 million revolving credit facility, which includes a maximum $10.0 million letter of credit facility. The revolving credit facility matures on September 30, 2016.

Our obligations under the credit agreement are secured by a security interest on substantially all of our assets, including our intellectual property. The credit agreement contains customary non-financial covenants, and also requires us to comply with financial covenants. One financial covenant requires us to maintain a total leverage ratio, which is defined as total consolidated debt divided by adjusted EBITDA (defined as earnings before interest expense, tax expense, depreciation, amortization and stock-based compensation, adjusted for certain other non-cash or non-recurring income or expenses such as specified litigation settlement payments and litigation expenses) for the trailing four quarters. In addition, we must maintain a minimum amount of liquidity based on our unrestricted cash and availability under the revolving credit facility. The covenant requires us to maintain a minimum liquidity of $25.0 million provided that at least $10.0 million of such liquidity is comprised of unrestricted cash and cash equivalents. The credit agreement includes customary events of default which, if triggered, could result in the acceleration of our obligations under the revolving credit facility, the termination of any obligation by the lenders to extend further credit and the right of the lenders to exercise their remedies as a secured creditor and foreclose upon the collateral securing our obligation under the credit agreement; however, we also have the ability, in certain instances, to cure non-compliance with the financial covenants through qualified equity contributions by certain holders of our equity. Currently, the agreement for our revolving credit facility contains restrictions on our ability to pay dividends. As of March 31, 2015, we had no outstanding balance on our credit facility and were in compliance with our covenants.

Statements of Cash Flows

The following table summarizes our cash flow related activities for the three months ended March 31, 2015 and 2014 (in thousands):

	Three Months Ended March 31,	
	2015	2014
Cash provided by (used in):		
Operating activities	$(5,498)	$(2,971)
Investing activities	(901)	(2,022)
Financing activities	64	106,349
Net increase (decrease) in cash and cash equivalents	$(6,335)	$101,356

Cash Flows from Operating Activities

Our cash used in operating activities is driven primarily by sales of our products and, to a lesser extent, by up-front payments from end-customers under PCS contracts. Our primary uses of cash from operating activities have been for personnel-related expenditures, manufacturing costs, marketing and promotional expenses, costs related to our facilities and litigation expenses. Our cash flows from operating activities will continue to be affected principally by the extent to which we increase spending on personnel and sales and marketing activities, our working capital requirements, and litigation expenses.

During the three months ended March 31, 2015, cash used in operating activities was $5.5 million, consisting of a net loss of $13.7 million partially offset by non-cash charges of $7.1 million and a $1.1 million increase in net operating assets and liabilities. Our non-cash charges consisted primarily of stock-based compensation of $4.6 million and depreciation and amortization of $2.5 million. The changes in our net operating assets and liabilities were primarily due to a $3.6 million decrease in accounts payable and accrued liabilities, partially offset by a $2.4 million increase in deferred revenue, a $1.3 million decrease in accounts receivable, and a $0.7 million decrease in prepaid expenses and other current assets.

The decrease in accounts payable and accrued liabilities was primarily attributable to a decrease in accrued compensation costs largely due to the payment of accrued commissions and bonuses, partially offset by an increase in accrued compensation costs related to our 2014 Employee Stock Purchase Plan; and the timing of vendor invoice payments. The increase in deferred revenue was due to timing of billings of support contracts and the increase in PCS sales in connection with our increasing installed customer base. The decrease in accounts receivable was primarily due to the timing of billing and cash collection, as a higher portion of the December 31, 2014 outstanding accounts receivable were billed during the latter part of the quarter compared to the March 31, 2015 outstanding accounts receivable.

During the three months ended March 31, 2014, cash used in operating activities was $3.0 million, consisting of a net loss of $5.1 million and a $2.0 million increase in net operating assets and liabilities offset by non-cash charges of $4.1 million. Our non-cash charges consisted primarily of depreciation and amortization of $2.2 million and stock-based compensation of $1.8 million. The change in our net operating assets and liabilities was due primarily to a $1.2 million increase in accounts receivable, $1.8 million increase in inventory and a $2.3 million increase in prepaid expenses and other current assets associated with the growth in our business. These changes were offset by a $2.7 million increase in deferred revenue due to increased sales of our PCS contracts and a $0.9 million increase in accrued liabilities.

Cash Flows from Investing Activities

During the three months ended March 31, 2015 and 2014, cash used in investing activities was $0.9 million and $2.0 million, primarily for purchases of property and equipment.

Cash Flows from Financing Activities

During the three months ended March 31, 2015, cash provided by financing activities was $0.1 million, consisting of proceeds from common stock issuance under our equity incentive plans, net of repurchases of common stock.

During the three months ended March 31, 2014, cash provided by financing activities was $106.3 million, consisting of $124.2 million in net proceeds from the issuance of our common stock to outside investors in our IPO, and $2.2 million from the exercise of common stock options, offset by a $20.0 million repayment of our revolving credit facility.

Contractual Obligations

In September 2013, we entered into a credit agreement with Royal Bank of Canada, JPMorgan Chase Bank, N.A. and Bank of America, N.A. as lenders. The credit agreement provides a three-year $35.0 million revolving credit facility, which includes a maximum $10.0 million letter of credit facility. We have no outstanding borrowings under this credit facility as of March 31, 2015.

Off-Balance Sheet Arrangements

As of March 31, 2015, we did not have any relationships with any unconsolidated entities or financial partnerships,such as entities often referred to 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.

Critical Accounting Policies and Estimates

Our condensed consolidated financial statements are prepared in accordance with U.S. GAAP. The preparation of these condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, expenses and related disclosures. We evaluate our estimates and assumptions on an ongoing basis. Our estimates are based on historical experience and various other assumptions that we believe to be reasonable under the circumstances. Our actual results could differ from these estimates.

There were no significant changes in our critical accounting policies and estimates during the three months ended March 31, 2015 as compared to the critical accounting policies and estimates disclosed in Management's Discussion and Analysis of Financial Condition and Results of Operations included in our annual report on Form 10-K filed with the SEC on March 11, 2015.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK
Foreign Currency Risk

Our consolidated results of operations, financial position and cash flows are subject to fluctuations due to changes in foreign currency exchange rates. Historically, the majority of our revenue contracts are denominated in U.S. dollars, with the most significant exception being Japan where we invoice primarily in the Japanese yen. Our costs and expenses are generally denominated in the currencies where our operations are located, which is primarily in North America, Japan and to a lesser extent EMEA and the Asia Pacific region. To date, we have not entered into any hedging arrangements with respect to foreign currency risk or other derivative instruments. Revenue resulting from selling in local currencies and costs and expenses incurred in local currencies are exposed to foreign currency exchange rate fluctuations which can affect our revenue and operating income. As exchange rates vary, operating income may differ from expectations.

The functional currency of our foreign subsidiaries is the U.S. dollar. At the end of each reporting period, monetary assets and liabilities are remeasured to the functional currency using exchange rates in effect at the balance sheet date. Nonmonetary assets and liabilities are remeasured at historical exchange rates. Gains and losses related to remeasurement are recorded in interest income and other income (expense), net in the Consolidated Statements of Operations. A significant fluctuation in the exchange rates between our subsidiaries' local currencies, especially the Japanese yen and the Euro, and the U.S. dollar could have an adverse impact on our consolidated financial position and results of operations.

We recorded $10,000 foreign exchange loss and $23,000 foreign exchange gain during the three months ended March 31, 2015 and 2014. The effect of a hypothetical 10% change in our exchange rate would not have a significant impact on our consolidated results of operations.

Interest Rate Sensitivity

Our exposure to market risk for changes in interest rates relates primarily to our cash and cash equivalents and our indebtedness. Our cash and cash equivalents are held in cash deposits and money market funds with maturities of less than 90 days from the date of purchase. Our primary exposure to market risk is interest income sensitivity, which is affected by changes in the general level of the interest rates in the United States. However, because of the short-term nature of the instruments in our portfolio, a sudden change in market interest rates would not be expected to have a material impact on our consolidated financial statements.

Our exposure to interest rate risk relates to our revolving credit facility with variable interest rates, where an increase in interest rates may result in higher borrowing costs. Since we have no outstanding borrowings under our credit facility as of March 31, 2015, the effect of a hypothetical 10% change in interest rates would not have a significant impact on our interest expense.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures, as required by Rule 13a-15(b) under the Securities Exchange Act of 1934 as amended (the “Exchange Act”) , as of March 31, 2015. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective as of March 31, 2015 solely due to the material weakness in our internal control over financial reporting as described below.

Changes in Internal Control over Financial Reporting

As of March 31, 2015, our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated our internal control over financial reporting. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that no changes in our internal control over financial reporting occurred during the quarter ended March 31, 2015 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting, except as described below with regards to computation of stock-based compensation related to our 2014 Purchase Plan.

As discussed in Item 9A. Controls and Procedures in our Annual Report on Form 10-K for the year ended December 31, 2014, management identified a material weakness in our internal control over financial reporting as it relates to the computation of stock-based compensation associated with our 2014 Purchase Plan.

In response to the material weakness described above, during the three months ended March 31, 2015, we began implementing and evaluating new controls and procedures. Though management is still evaluating the design of these new procedures, we believe that our improved processes and procedures will assist in the remediation of our material weakness. Once placed in operation for a sufficient period of time, we will subject these procedures to appropriate tests, in order to determine whether they are operating effectively. In designing and evaluating the stock-based compensation controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives.

Management has implemented the following steps during the first quarter of 2015:

- We added a control activity where we will consult with technical accounting experts to review and analyze the impact of new or unusual accounting transactions and the adoption of new accounting standards that may have a material impact on our consolidated financial statements.

- We strengthened our processes in the area of equity administration and equity accounting, which included the review, redesign and documentation of our policies and procedures; implementation of additional review and reconciliation controls, and expanded the use of software based solutions to handle certain aspects of accounting for stock-based compensation related to the 2014 Purchase Plan.

We will continue to evaluate the effectiveness of our internal controls and procedures on an ongoing basis and will take further action, as appropriate.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We have been and may currently be involved in various legal proceedings, the outcomes of which are not within our complete control or may not be known for prolonged periods of time. Management is required to assess the probability of loss and amount of such loss, if any, in preparing our consolidated financial statements. We evaluate the likelihood of a potential loss from legal proceedings to which we are a party. We record a liability for such claims when a loss is deemed probable and the amount can be reasonably estimated. Significant judgment may be required in the determination of both probability and whether an exposure is reasonably estimable. Our judgments are subjective based on the status of the legal proceedings, the merits of our defenses and consultation with in-house and outside legal counsel. As additional information becomes available, we reassess the potential liability related to pending claims and may revise our estimates. Due to the inherent uncertainties of the legal processes in the multiple jurisdictions in which we operate, our judgments may be materially different than the actual outcomes, which could have material adverse effects on our business, financial conditions and results of operations.

Additional information with respect to this Item may be found in Note 5. Commitments and Contingencies, in the Notes to Condensed Consolidated Financial Statements of this Quarterly Report on Form 10-Q, which is incorporated into this Item 1 by reference.

ITEM 1A. RISK FACTORS

Investing in our common stock involves a high degree of risk. You should carefully consider the risks and uncertainties described below, together with all of the other information contained in this report, and in our other public filings. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties that we are unaware of, or that we currently believe are not material, may also become important factors that affect us. If any of the following risks occur, our business, financial condition, operating results, and prospects could be materially harmed. In that event, the trading price of our common stock could decline, perhaps significantly.

If we do not successfully anticipate market needs and opportunities or if the market does not continue to adopt our application networking products, our business, financial condition and results of operations could be significantly harmed.

The application networking market is rapidly evolving and difficult to predict. Technologies, customer requirements, security threats and industry standards are constantly changing. As a result, we must anticipate future market needs and opportunities and then develop new products or enhancements to our current products that are designed to address those needs and opportunities, and we may not be successful in doing so.

Even if we are able to anticipate, develop and commercially introduce new products and enhancements that address the market's needs and opportunities, there can be no assurance that new products or enhancements will achieve widespread market acceptance. For example, organizations that use other conventional or first-generation application networking products for their needs may believe that these products are sufficient. In addition, as we launch new product offerings, organizations may not believe that such new product offerings offer any additional benefits as compared to the existing application networking products that they currently use. Accordingly, organizations may continue allocating their IT budgets for existing application networking products and may not adopt our products, regardless of whether our products can offer superior performance or security.

If we fail to anticipate market needs and opportunities or if the market does not continue to adopt our application networking products, then market acceptance and sales of our current and future application networking products could be substantially decreased or delayed, we could lose customers, and our revenue may not grow or may decline. Any of such events would significantly harm our business, financial condition and results of operations.

Our success depends on our timely development of new products and features to address rapid technological changes and evolving customer requirements. If we are unable to timely develop new products and features that adequately address these changes and requirements, our business and operating results could be adversely affected.

Changes in application software technologies, data center and communications hardware, networking software and operating systems, and industry standards, as well as our end-customers' continuing business growth, result in evolving application networking needs and requirements. Our continued success depends on our ability to identify and develop in a timely manner new products and new features for our existing products that meet these needs and requirements.

Our future plans include significant investments in research and development and related product opportunities. Developing our products and related enhancements is time-consuming and expensive. We have made significant investments in our research and development team in order to address these product development needs. Our investments in research and development may not result in significant design and performance improvements or marketable products or features, or may result in products that are more expensive than anticipated. We may take longer to generate revenue, or generate less revenue, than we anticipate from our new products and product enhancements. We believe that we must continue to dedicate a significant amount of resources to our research and development efforts to maintain our competitive position.

If we are unable to develop new products and features to address technological changes and new customer requirements in the application networking market or if our investments in research and development do not yield the expected benefits in a timely manner, our business and operating results could be adversely affected.

We have experienced net losses in recent periods, anticipate increasing our operating expenses in the future and may not achieve or maintain profitability in the future. If we cannot achieve or maintain profitability, our financial performance will be harmed and our business may suffer.

We experienced net losses for the years ended December 31, 2013 and 2014, and three months ended March 31, 2015. Although we experienced revenue growth over these same periods and had achieved profitability in prior year periods, we may not be able to sustain or increase our revenue growth or achieve profitability in the future or on a consistent basis. During 2013 and 2014, we invested in our sales, marketing and research and development teams in order to develop, market and sell our products. We expect to continue to invest significantly in these areas in the future. As a result of these increased expenditures, we will have to generate and sustain increased revenue, manage our cost structure and avoid significant liabilities to achieve future profitability. In particular, in 2012 and 2013, we incurred substantial expenses associated with defending ourselves in separate litigation matters involving Brocade Communications Systems, Inc. and Radware Ltd. (both settled) and in our settlement of the Brocade litigation. As a public company, we will also incur significant accounting, legal and other expenses that we did not incur as a private company.

Revenue growth may slow or decline, and we may incur significant losses in the future for a number of possible reasons, including our inability to develop products that achieve market acceptance, general economic conditions, increasing competition, decreased growth in the markets in which we operate, or our failure for any reason to capitalize on growth opportunities. Additionally, we may encounter unforeseen operating expenses, difficulties, complications, delays and other unknown factors that may result in losses in future periods. If these losses exceed our expectations or our revenue growth expectations are not met in future periods, our financial performance will be harmed and our stock price could be volatile or decline.

Our operating results are likely to vary significantly from period to period and may be unpredictable, which could cause the trading price of our common stock to decline.

Our operating results – in particular, revenue, margins and operating expenses – have fluctuated in the past, and we expect this will continue, which makes it difficult for us to predict our future operating results. The timing and size of sales of our products are highly variable and difficult to predict and can result in significant fluctuations in our revenue from period to period. This is particularly true of sales to our largest end-customers, such as service providers, Web giants and governmental organizations, who typically make large and concentrated purchases and for whom close or sales cycles can be long, as a result of their complex networks and data centers, as well as requests that may be made for customized features. Our quarterly results may vary significantly based on when these large end-customers place orders with us and the content of their orders. For example, during the three months ended September 30, 2014, we experienced a decline in our revenues primarily due to longer than expected close or sales cycles for certain large deals and lower North America service provider spending as compared to the same period in 2013, which may have contributed to a dramatic decline in our stock price. We anticipate a possible slowdown in spending from North America service providers, which may lead to continued near term fluctuation in our products revenue and total revenue.

Our operating results may also fluctuate due to a number of other factors, many of which are outside of our control and may be difficult to predict. In addition to other risks listed in this “Risk Factors” section, factors that may affect our operating results include:

- fluctuations in and timing of purchases from, or loss of, large customers;
- the budgeting cycles and purchasing practices of end-customers;
- our ability to attract and retain new end-customers;
- changes in demand for our products and services, including seasonal variations in customer spending patterns or cyclical fluctuations in our markets;
- our reliance on shipments at the end of our quarters;
- variations in product mix or geographic locations of our sales, which can affect the revenue we realize for those sales;
- the timing and success of new product and service introductions by us or our competitors;
- our ability to increase the size of our distribution channel and to maintain relationships with important distribution channel partners;
- the effect of currency exchange rates on our revenue and expenses;
- the cost and potential outcomes of existing and future litigation;

- the effect of discounts negotiated by our largest end-customers for sales or pricing pressure from our competitors;
- changes in the growth rate of the application networking market or changes in market needs;
- inventory write downs, which may be necessary for our older products when our new products are launched and adopted by our end-customers; and

28

- our third-party manufacturers' and component suppliers' capacity to meet our product demand forecasts on a timely basis, or at all.

Any one of the factors above or the cumulative effect of some of these factors may result in significant fluctuations in our financial and other operating results. This variability and unpredictability could result in our failure to meet our or our investors' or securities analysts' revenue, margin or other operating results expectations for a particular period, resulting in a decline in the trading price of our common stock.

Reliance on shipments at the end of the quarter could cause our revenue for the applicable period to fall below expected levels.

As a result of end-customer buying patterns and the efforts of our sales force and distribution channel partners to meet or exceed their sales objectives, we have historically received a substantial portion of purchase orders and generated a substantial portion of revenue during the last few weeks of each quarter. We can recognize such revenue in the quarter received, however, only if all of the requirements of revenue recognition, especially shipment, are met by the end of the quarter. In addition, any significant interruption in our information technology systems, which manage critical functions such as order processing, revenue recognition, financial forecasts, inventory and supply chain management, could result in delayed order fulfillment and thus decreased revenue for that quarter. If expected revenue at the end of any quarter is delayed for any reason, including the failure of anticipated purchase orders to materialize, our third-party manufacturers' inability to manufacture and ship products prior to quarter-end to fulfill purchase orders received near the end of the quarter, our failure to manage inventory to meet demand, our inability to release new products on schedule, any failure of our systems related to order review and processing, or any delays in shipments or achieving specified acceptance criteria, our revenue for that quarter could fall below our, or our investors' or securities analysts' expectations, resulting in a decline in the trading price of our common stock.

A limited number of our end-customers, including service providers, make large and concentrated purchases that comprise a significant portion of our revenue. Any loss or delay of expected purchases by our largest end-customers could adversely affect our operating results.

As a result of the nature of our target market and the current stage of our development, a substantial portion of our revenue in any period comes from a limited number of large end-customers, including service providers. For example, NTT DoCoMo, Inc., through a reseller, accounted for approximately 32% of our total revenue during 2012, approximately 13% of our total revenue during 2013 and 7% of our total revenue during 2014. In addition, during the years ended December 31, 2013 and 2014, and three months ended March 31, 2015, purchases from our ten largest end-customers accounted for approximately 43% , 37% and 42% of our total revenue. The composition of the group of these ten largest end-customers changes from period to period, but often includes service providers, who accounted for approximately 47%, 46% and 43% of our total revenue during the years ended December 31, 2013 and 2014, and three months ended March 31, 2015.

Sales to these large end-customers have typically been characterized by large but irregular purchases with long initial sales cycles. After initial deployment, subsequent purchases of our products typically have a more compressed sales cycle. The timing of these purchases and of the requested delivery of the purchased product is difficult to predict. As a consequence, any acceleration or delay in anticipated product purchases by or requested deliveries to our largest end-customers could materially affect our revenue and operating results in any quarter and cause our quarterly revenue and operating results to fluctuate from quarter to quarter.

We cannot provide any assurance that we will be able to sustain or increase our revenue from our largest end-customers nor that we will be able to offset any absence of significant purchases by our largest end-customers in any particular period with purchases by new or existing end-customers in that or a subsequent period. We expect that sales of our products to a limited number of end-customers will continue to contribute materially to our revenue for the foreseeable future. The loss of, or a significant delay or reduction in purchases by, a small number of end-customers could have a material adverse effect on our consolidated financial position, results of operations or cash flows.

We have been and are a party to litigation and claims regarding intellectual property rights, resolution of which has been and may in the future be time-consuming, expensive and adverse to us, as well as require a significant amount of resources to prosecute, defend, or make our products non-infringing.

Our industry is characterized by the existence of a large number of patents and by increasingly frequent claims and related litigation based on allegations of infringement or other violations of patent and other intellectual property rights. In the ordinary course of our business, we have been and are involved in disputes and licensing discussions with others regarding their patents and other claimed intellectual property and proprietary rights. Intellectual property infringement and misappropriation lawsuits and other claims are subject to inherent uncertainties due to the complexity of the technical and legal issues involved, and we cannot be certain that we will be successful in defending ourselves against such claims or in concluding licenses on reasonable terms or at all.

We currently have fewer issued patents than some of our major competitors, and therefore may not be able to utilize our patent portfolio effectively to assert defenses or counterclaims in response to patent infringement claims or litigation brought against us by third parties. Further, litigation may involve patent holding companies or other adverse patent owners that have no relevant products revenue and against which our potential patents may provide little or no deterrence. In addition, many potential litigants have the capability to dedicate substantially greater resources than we can to enforce their intellectual property rights and to defend claims that may be brought against them. We expect that infringement claims may increase as the numbers of product types and the number of competitors in our market increases. Also, to the extent we gain greater visibility, market exposure and competitive success, we face a higher risk of being the subject of intellectual property infringement claims.

If we are found in the future to infringe the proprietary rights of others, or if we otherwise settle such claims, we could be compelled to pay damages or royalties and either obtain a license to those intellectual property rights or alter our products such that they no longer infringe. Any license could be very expensive to obtain or may not be available at all. Similarly, changing our products or processes to avoid infringing the rights of others may be costly, time-consuming or impractical. Alternatively, we could also become subject to an injunction or other court order that could prevent us from offering our products. Any of these claims, regardless of their merit, may be time-consuming, result in costly litigation and diversion of technical and management personnel, or require us to cease using infringing technology, develop non-infringing technology or enter into royalty or licensing agreements.

Many of our commercial agreements require us to indemnify our end-customers, distributors and resellers for certain third-party intellectual property infringement actions related to our technology, which may require us to defend or otherwise become involved in such infringement claims, and we could incur liabilities in excess of the amounts we have received for the relevant products and/or services from our end-customers, distributors or resellers. These types of claims could harm our relationships with our end-customers, distributors and resellers, may deter future end-customers from purchasing our products or could expose us to litigation for these claims. Even if we are not a party to any litigation between an end-customer, distributor or reseller, on the one hand, and a third party, on the other hand, an adverse outcome in any such litigation could make it more difficult for us to defend our intellectual property rights in any subsequent litigation in which we are a named party.

We have in the past been involved in two intellectual property litigation matters with F5 Networks, Inc., one with Allegro Software Development, Inc., one with Brocade and one with Radware, all of which have since settled. As part of the settlement with Brocade, we made a significant cash payment to Brocade, granted a license to Brocade to use all of our issued, pending and future patents, and received and granted certain covenants not to sue. We are currently party to one intellectual property litigation matter. In November 2013, Parallel Networks, LLC, which we believe is a patent holding company, filed a lawsuit against us in the United States District Court for the District of Delaware alleging that our AX and Thunder series products infringe two of their patents. Parallel is seeking injunctive relief, damages and costs. While we intend to defend ourselves vigorously against the allegations in this lawsuit, this litigation matter, regardless of the outcome, could result in significant costs and diversion of our management’s efforts.

30

We may face risks related to securities litigation that could result in significant legal expenses and settlement or damage awards.

We are currently and may in the future become subject to claims and litigation alleging violations of securities laws or other related claims, which could harm our business, divert management attention and require us to incur significant costs. For example, in January 2015, a class action lawsuit was filed against us, our Board of Directors, our Chief Financial Officer and the underwriters of our initial public offering alleging violations of the Securities Act of 1933. Several substantially identical lawsuits were subsequently filed in the same court, bringing the same claims against the same defendants. These lawsuits seek unspecified compensatory damages and other relief. We are generally obliged, to the extent permitted by law, to indemnify our current and former directors and officers who are named as defendants in these types of lawsuits. We also have certain contractual obligations to the underwriters regarding these lawsuits. While a certain amount of insurance coverage is available for expenses or losses associated with these lawsuits, this coverage may not be sufficient. Based on information currently available, we are unable to reasonably estimate a possible loss or range of possible loss, if any, with regards to these lawsuits; therefore, no litigation reserve has been recorded in the accompanying Condensed Consolidated Balance Sheets. Although we plan to defend against these lawsuits vigorously, there can be no assurances that a favorable final outcome will be obtained. These lawsuits or future litigation may require significant attention from management and could result in significant legal expenses, settlement costs or damage awards that could have a material impact on our financial position, results of operations and cash flows.

We may not be able to adequately protect our intellectual property, and if we are unable to do so, our competitive position could be harmed, or we could be required to incur significant expenses to enforce our rights.

We rely on a combination of patent, copyright, trademark and trade secret laws, and contractual restrictions on disclosure of confidential and proprietary information, to protect our intellectual property. Despite the efforts we take to protect our intellectual property and other proprietary rights, these efforts may not be sufficient or effective at preventing their unauthorized use. In addition, effective trademark, patent, copyright and trade secret protection may not be available or cost-effective in every country in which we have rights. There may be instances where we are not able to protect intellectual property or other proprietary rights in a manner that maximizes competitive advantage. If we are unable to protect our intellectual property and other proprietary rights from unauthorized use, the value of those assets may be reduced, which could negatively impact our business.

We also rely in part on confidentiality and/or assignment agreements with our technology partners, employees, consultants, advisors and others. We did not, however, obtain general employee confidentiality and assignment agreements from certain former employees who worked with us prior to July 2010, although we did receive specific assignments from each of these employees who was an inventor of any technologies that we patented. These protections and agreements may not effectively prevent disclosure of our confidential information and may not provide an adequate remedy in the event of unauthorized disclosure. In addition, others may independently discover our trade secrets and intellectual property information we thought to be proprietary, and in these cases we would not be able to assert any trade secret rights against those parties. Despite our efforts to protect our intellectual property, unauthorized parties may attempt to copy or otherwise obtain and use our intellectual property or technology. Monitoring unauthorized use of our intellectual property is difficult and expensive. We have not made such monitoring a priority to date and will not likely make this a priority in the future. We cannot be certain that the steps we have taken or will take will prevent misappropriation of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States.

If we fail to protect our intellectual property adequately, our competitors might gain access to our technology, and our business might be harmed. In addition, even if we protect our intellectual property, we may need to license it to competitors, which could also be harmful. For example, we have already licensed all of our issued patents, pending applications, and future patents and patent applications that we may acquire, obtain, apply for or have a right to license to Brocade until May 2025, for the life of each such patent. In addition, we might incur significant expenses in defending our intellectual property rights. Any of our patents, copyrights, trademarks or other intellectual property rights could be challenged by others or invalidated through administrative process or litigation.

We may in the future initiate claims or litigation against third parties for infringement of our proprietary rights or to establish the validity of our proprietary rights. Any litigation, whether or not resolved in our favor, could result in significant expense to us and divert the efforts of our management and technical personnel, as well as cause other claims to be made against us, which might adversely affect our business, operating results and financial condition.

In addition, on March 20, 2014, we received a letter from an attorney on behalf of an individual who claims that he is entitled to between 1.6 and 2.6 million shares of our common stock.

The individual alleges that prior to the incorporation of our company he had been promised founders' shares in a different corporation. The individual also alleges that our Chief Executive Officer and founder, Lee Chen, who was involved with this different entity for a short period of time in mid-2004 before our founding, was the CEO and controlling stockholder of such other entity and that Mr. Chen breached his fiduciary duty to such entity and its stockholders. The individual further alleges that Mr. Chen misappropriated intellectual property and diverted employees and investors from that entity to us. On the basis of these allegations, this individual claims he is entitled to shares of our common stock. The individual also alleges that we knowingly aided and abetted Mr. Chen in such alleged actions. To our knowledge, this individual had not raised any of these allegations or made any equity ownership claims to us prior to our receipt of the email on March 20, 2014.

Based on our preliminary review of the allegations in the letter, we and Mr. Chen believe that the claims are without merit and are not likely to have a material adverse effect on us. However, there can be no assurances with respect to the outcome of these allegations. No lawsuit has been filed, and if a lawsuit is filed, we and Mr. Chen intend to defend against these claims vigorously.

We face intense competition in our market, especially from larger, well-established companies, and we may lack sufficient financial or other resources to maintain or improve our competitive position.

The application networking market is intensely competitive, and we expect competition to increase in the future. To the extent that we sell our solutions in adjacent markets, we expect to face intense competition in those markets as well. We believe that our main competitors fall into three categories:

- Companies that sell products in the traditional ADC market. In the ADC market, we compete against other companies that are well established in this market, including F5 Networks, Inc., Brocade, Cisco Systems, Inc., Citrix Systems, Inc., and Radware Ltd.;

- Companies that sell CGN products. Our purpose-built CGN solution competes primarily against products originally designed for other networking purposes, such as edge routers and security appliances from vendors such as Alcatel-Lucent USA Inc., Cisco Systems, Inc. and Juniper Networks, Inc.; and

- Companies that sell traditional DDoS mitigation products. We are a new entrant into the DDoS market and first publicly launched our DDoS detection and mitigation solution, TPS, in January 2014. We believe our principal competitors in this market are Arbor Networks, Inc., a subsidiary of Danaher Corporation, and Radware.

Many of our competitors are substantially larger and have greater financial, technical, research and development, sales and marketing, manufacturing, distribution and other resources and greater name recognition. In addition, some of our larger competitors have broader products offerings and could leverage their customer relationships based on their other products. Potential customers who have purchased products from our competitors in the past may also prefer to continue to purchase from these competitors rather than change to a new supplier regardless of the performance, price or features of the respective products. We could also face competition from new market entrants, which may include our current technology partners. As we continue to expand globally, we may also see new competitors in different geographic regions. Such current and potential competitors may also establish cooperative relationships among themselves or with third parties that may further enhance their resources.

Many of our existing and potential competitors enjoy substantial competitive advantages, such as:

- longer operating histories;

-

- the capacity to leverage their sales efforts and marketing expenditures across a broader portfolio of products and services at a greater range of prices;
- the ability to incorporate functionality into existing products to gain business in a manner that discourages users from purchasing our products, including through selling at zero or negative margins, product bundling or closed technology platforms;
- broader distribution and established relationships with distribution channel partners in a greater number of worldwide locations;
- access to larger end-customer bases;

- the ability to use their greater financial resources to attract our research and development engineers as well as other employees of ours;
- larger intellectual property portfolios; and
- the ability to bundle competitive offerings with other products and services.

Our ability to compete will depend upon our ability to provide a better solution than our competitors at a competitive price. We may be required to make substantial additional investments in research and development, marketing and sales in order to respond to competition, and there is no assurance that these investments will achieve any returns for us or that we will be able to compete successfully in the future. We also expect increased competition if our market continues to expand. Moreover, conditions in our market could change rapidly and significantly as a result of technological advancements or other factors.

In addition, current or potential competitors may be acquired by third parties that have greater resources available. As a result of these acquisitions, our current or potential competitors might take advantage of the greater resources of the larger organization to compete more vigorously or broadly with us. In addition, continued industry consolidation might adversely impact end-customers' perceptions of the viability of smaller and even medium-sized networking companies and, consequently, end-customers' willingness to purchase from companies like us.

As a result, increased competition could lead to fewer end-customer orders, price reductions, reduced margins and loss of market share.

Some of our large end-customers demand favorable terms and conditions from their vendors and may request price concessions. As we seek to sell more products to these end-customers, we may agree to terms and conditions that may have an adverse effect on our business.

Some of our large end-customers have significant purchasing power and, accordingly, have requested from us and received more favorable terms and conditions, including lower prices than we typically provide. As we seek to sell products to this class of end-customer, we may agree to these terms and conditions, which may include terms that reduce our gross margin and have an adverse effect on our business.

If we are unable to attract new end-customers, sell additional products to our existing end-customers or achieve the anticipated benefits from our investment in additional sales personnel and resources, our revenue may decline, and our gross margin will be adversely affected.

To maintain and increase our revenue, we must continually add new end-customers and sell additional products to existing end-customers. The rate at which new and existing end-customers purchase solutions depends on a number of factors, including some outside of our control, such as general economic conditions. If our efforts to sell our solutions to new end-customers and additional solutions to our existing end-customers are not successful, our business and operating results will suffer.

In recent periods, we have been adding personnel and other resources to our sales and marketing functions, as we focus on growing our business, entering new markets and increasing our market share. We expect to incur significant additional expenses by hiring additional sales personnel and expanding our international operations in order to seek revenue growth. The return on these and future investments may be lower, or may be realized more slowly, than we expect, if realized at all. If we do not achieve the benefits anticipated from these investments, or if the achievement of these benefits is delayed, our growth rates will decline, and our gross margin would likely be adversely affected.

Our gross margin may fluctuate from period to period based on the mix of products sold, the geographic location of our customers, price discounts offered, required inventory write downs and current exchange rate fluctuations.

Our gross margin may fluctuate from period to period in response to a number of factors, such as the mix of our products sold and the geographic locations of our sales. Our products tend to have varying gross margins in different geographic regions. We also may offer pricing discounts from time to time as part of a targeted sales campaign or as a result of pricing pressure from our competitors. In addition, our larger end-customers may negotiate pricing discounts in connection with large orders they place with us. The sale of our products at discounted prices could have a negative impact on our gross margin. We also must manage our inventory of existing products when we introduce new products. For example, in the fourth quarter of 2013 and the third quarter of 2014, our gross margin decreased to 74% and 73% due primarily to geographical mix and selling some end-of-life product at low margins.

If we are unable to sell the remaining inventory of our older products prior to or following the launch of such new product offerings, we may be forced to write down inventory for such older products, which could also negatively affect our gross margin. Our gross margin may also vary based on international currency exchange rates. In general, our sales are denominated in U.S. dollars; however, in Japan they are denominated in Japanese yen. Changes in the exchange rate between the U.S. dollar and the Japanese yen may therefore affect our actual revenue and gross margin. For example, in the third and fourth quarters of 2014, our gross margin was adversely impacted by both an increase in our inventory reserve primarily due to obsolete inventory on hand and unfavorable exchange rate fluctuations between the U.S. dollar and the Japanese yen.

We generate a significant amount of revenue from sales to distributors, resellers, and end-customers outside of the United States, and we are therefore subject to a number of risks that could adversely affect these international sources of our revenue.

A significant portion of our revenue is generated in international markets, including Japan, Western Europe, China, Taiwan and South Korea. For the years ended December 31, 2013 and 2014, and three months ended March 31, 2015 approximately 52%, 52% and 48% of our total revenue was generated from customers located outside of the United States. If we are unable to maintain or continue to grow our revenue in these markets, our financial results may suffer.

As a result, we must hire and train experienced personnel to staff and manage our foreign operations. To the extent that we experience difficulties in recruiting, training, managing and retaining an international staff, and specifically sales management and sales personnel, we may experience difficulties in sales productivity in foreign markets. We also seek to enter into distributor and reseller relationships with companies in certain international markets where we do not have a local presence. If we are not able to maintain successful distributor relationships internationally or recruit additional companies to enter into distributor relationships, our future success in these international markets could be limited. Business practices in the international markets that we serve may differ from those in the United States and may require us in the future to include terms in customer contracts other than our standard terms. To the extent that we may enter into customer contracts in the future that include non-standard terms, our operating results may be adversely impacted.

We have a significant presence in international markets and plan to continue to expand our international operations, which exposes us to a number of risks that could affect our future growth.

Our sales team is comprised of field sales and inside sales personnel who are organized by geography and maintain sales presence in 28 countries, including in the following countries and regions: United States, Western Europe, Japan, Ch