Five9, Inc.
Form 10-Q
November 06, 2018
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2018
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number: 001-36383

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

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

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

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

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

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. Yes: o No: o

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

As of October 26, 2018, there were 58,771,956 shares of the Registrant's common stock, par value $0.001 per share, outstanding.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

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

- our quarterly and annual results may fluctuate significantly, including as a result of the timing and success of new product and feature introductions by us, may not fully reflect the underlying performance of our business and may result in decreases in the price of our common stock;
- if we are unable to attract new clients or sell additional services and functionality to our existing clients, our revenue and revenue growth will be harmed;
- our recent rapid growth may not be indicative of our future growth, and even if we continue to grow rapidly, we may fail to manage our growth effectively;
- failure to adequately expand our sales force could impede our growth;
- if we fail to manage our technical operations infrastructure, our existing clients may experience service outages, our new clients may experience delays in the deployment of our solution and we could be subject to, among other things, claims for credits or damages;
- security breaches and improper access to or disclosure of our data or our clients’ data, or other cyber attacks on our systems, could result in litigation and regulatory risk, harm our reputation and adversely affect our business;
- the markets in which we participate are highly competitive, and if we do not compete effectively, our operating results could be harmed;
- if our existing clients terminate their subscriptions or reduce their subscriptions and related usage, our revenues and gross margins will be harmed and we will be required to spend more money to grow our client base;
- our growth depends in part on the success of our strategic relationships with third parties and our failure to successfully grow and manage these relationships could harm our business;
- we are establishing a network of master agents and resellers to sell our solution; our failure to effectively develop, manage, and maintain this network could materially harm our revenues;
- we sell our solution to larger organizations that require longer sales and implementation cycles and often demand more configuration and integration services or customized features and functions that we may not offer, any of which could delay or prevent these sales and harm our growth rates, business and operating results;
- because a significant percentage of our revenue is derived from existing clients, downturns or upturns in new sales will not be immediately reflected in our operating results and may be difficult to discern;
- any disruption, price increase or degradation in the third-party telecommunications and internet services used by our clients and their customers to connect to and use our cloud contact center software, could impair or reduce our clients’ use of our solution, cause us to lose clients and subject us to reputational harm as well as claims for credits or damages;
- we have a history of losses and we may be unable to achieve or sustain profitability;
- the contact center software solutions market is subject to rapid technological change, and we must develop and sell incremental and new products in order to maintain and grow our business;

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- we may not be able to secure additional financing on favorable terms, or at all, to meet our future capital needs;
- we may not have sufficient cash to service our convertible senior notes and repay such notes, if required; and
- failure to comply with laws and regulations could harm our business and our reputation.

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

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

	September 30, 2018 (Unaudited)	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 79,619	$ 68,947
Marketable investments	200,007	—
Accounts receivable, net	23,903	19,048
Prepaid expenses and other current assets	7,962	4,840
Deferred contract acquisition costs	8,633	—
Total current assets	320,124	92,835
Property and equipment, net	22,909	19,888
Intangible assets, net	724	1,073
Goodwill	11,798	11,798
Other assets	962	2,602
Deferred contract acquisition costs — less current portion	19,599	—
Total assets	$ 376,116	$ 128,196
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 4,528	$ 4,292
Accrued and other current liabilities	14,144	11,787
Accrued federal fees	1,681	1,151
Sales tax liability	1,322	1,326
Notes payable	—	336
Capital leases	6,909	6,651
Deferred revenue	17,490	13,975
Total current liabilities	46,074	39,518
Convertible senior notes	193,664	—
Revolving line of credit	—	32,594
Sales tax liability — less current portion	884	1,044
Capital leases — less current portion	6,250	7,161
Other long-term liabilities	1,360	1,041
Total liabilities	248,232	81,358
Commitments and contingencies (Note 10)		
Stockholders' equity:		
Preferred stock, $0.001 par value; 5,000 shares authorized, no shares issued and outstanding at September 30, 2018 and December 31, 2017	—	—
Common stock, $0.001 par value; 450,000 shares authorized, 58,749 shares and 56,632 shares issued and outstanding at September 30, 2018 and December 31, 2017, respectively	59	57
Additional paid-in capital	283,055	222,202
Accumulated deficit	(155,230)	(175,421)
Total stockholders' equity	127,884	46,838

Total liabilities and stockholders' equity	$ 376,116	$ 128,196

See accompanying notes to the unaudited condensed consolidated financial statements.

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

	Three Months Ended		Nine Months Ended	
	September 30, 2018	September 30, 2017	September 30, 2018	September 30, 2017
Revenue	$65,304	$ 50,081	$185,329	$ 144,822
Cost of revenue	26,179	20,497	75,695	60,741
Gross profit	39,125	29,584	109,634	84,081
Operating expenses:				
Research and development	9,582	6,689	25,721	20,372
Sales and marketing	17,818	16,502	53,208	49,212
General and administrative	10,746	4,679	29,682	20,384
Total operating expenses	38,146	27,870	108,611	89,968
Income (loss) from operations	979	1,714	1,023	(5,887)
Other income (expense), net:				
Interest expense	(3,595)	(865)	(6,783)	(2,635)
Interest income and other	1,352	118	1,956	326
Total other income (expense), net	(2,243)	(747)	(4,827)	(2,309)
Income (loss) before income taxes	(1,264)	967	(3,804)	(8,196)
Provision for income taxes	41	43	150	142
Net income (loss)	$(1,305)	$ 924	$(3,954)	$ (8,338)
Net income (loss) per share:				
Basic	$(0.02)	$ 0.02	$(0.07)	$ (0.15)
Diluted	$(0.02)	$ 0.02	$(0.07)	$ (0.15)
Shares used in computing net income (loss) per share:				
Basic	58,454	55,310	57,790	54,579
Diluted	58,454	59,441	57,790	54,579
Comprehensive Income (Loss):				
Net income (loss) and comprehensive income (loss)	$(1,305)	$ 924	$(3,954)	$ (8,338)

See accompanying notes to the unaudited condensed consolidated financial statements.

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

	Nine Months Ended	
	September 30, 2018	September 30, 2017
Cash flows from operating activities:		
Net loss	$(3,954)	$ (8,338)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	7,436	6,246
Amortization of premium on marketable investments	(317)	—
Provision for doubtful accounts	81	66
Stock-based compensation	20,991	10,703
Reversal of interest and penalties on accrued federal fees	—	(2,133)
Gain on sale of convertible note held for investment	(312)	—
Non-cash adjustment on investment	(40)	(233)
Amortization of debt discount and issuance costs	129	60
Amortization of discount and issuance costs on convertible senior notes	4,782	—
Accretion of interest	44	16
Others	(59)	(50)
Changes in operating assets and liabilities:		
Accounts receivable	(4,931)	(3,406)
Prepaid expenses and other current assets	(2,755)	(1,861)
Deferred contract acquisition costs	(5,094)	—
Other assets	68	71
Accounts payable	307	1,409
Accrued and other current liabilities	2,575	1,774
Accrued federal fees and sales tax liability	366	95
Deferred revenue	3,910	3,676
Other liabilities	(75)	131
Net cash provided by operating activities	23,152	8,226
Cash flows from investing activities:		
Purchases of marketable investments	(203,953)	—
Proceeds from maturities of marketable investments	4,047	—
Purchases of property and equipment	(4,503)	(1,809)
Proceeds from sale of convertible note held for investment	1,923	—
Net cash used in investing activities	(202,486)	(1,809)
Cash flows from financing activities:		
Proceeds from issuance of convertible senior notes, net of issuance costs paid of $8,036	250,714	—
Payments for capped call transactions	(31,412)	—
Proceeds from exercise of common stock options	7,111	3,280
Proceeds from sale of common stock under ESPP	2,884	1,800
Repayments on revolving line of credit	(32,594)	—
Payments of notes payable	(318)	(547)
Payments of capital leases	(6,379)	(5,708)
Net cash provided by (used in) financing activities	190,006	(1,175)
Net increase in cash and cash equivalents	10,672	5,242
Cash and cash equivalents:		
Beginning of period	68,947	58,122

End of period	$79,619	$ 63,364
Supplemental disclosures of cash flow data:		
Cash paid for interest	$1,850	$ 2,588
Cash paid for income taxes	$151	$ 113
Non-cash investing and financing activities:		
Equipment obtained under capital lease	$4,981	$ 7,482
Equipment purchased and unpaid at period-end	$779	$ 22

See accompanying notes to the unaudited condensed consolidated financial statements.

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FIVE9, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

1. Description of Business and Summary of Significant Accounting Policies

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

Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (“GAAP”) and applicable rules and regulations of the Securities and Exchange Commission (“SEC”) regarding interim financial reporting. Certain information and note disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Therefore, these condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017. In the opinion of management, the condensed consolidated financial statements reflect all adjustments, which are normal and recurring in nature, necessary for fair financial statement presentation. All intercompany transactions and balances have been eliminated in consolidation.

Certain prior period amounts included in the condensed consolidated financial statements have been reclassified to conform to the current period presentation.

Use of Estimates

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

Cash and Cash Equivalents

The Company’s cash and cash equivalents consist of highly liquid investments with maturities of three months or less at the time of purchase. The Company’s cash equivalents consist of investments in money market funds and commercial paper.

Marketable Investments

The Company’s marketable investments consist of U.S agency securities and government sponsored securities, U.S. treasury securities, certificates of deposit, municipal bonds, corporate bonds and commercial paper. The Company determines the appropriate classification of its investments in marketable investments at the time of purchase and re-evaluates such designation at each balance sheet date. The Company’s marketable investments have been classified and accounted for as available-for-sale. Marketable investments are carried at fair value.

Significant Accounting Policies

The Company’s significant accounting policies are disclosed in its Annual Report on Form 10-K for the year ended December 31, 2017. Other than the accounting policies discussed in Note 2 related to the adoption of ASC 606, there has been no material change to the Company’s significant accounting policies during the nine months ended September 30, 2018. See Note 2 for the updated accounting policies.

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Recently Adopted Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standard Update ("ASU") 2014-09, Revenue from Contracts with Customers: Topic 606, amending revenue recognition guidance and requiring more detailed disclosures to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. ASU 2014-09 also includes Subtopic 340-40, Other Assets and Deferred Costs - Contracts with Customers, which requires the deferral of incremental costs of obtaining a contract with a customer. The Company adopted ASU 2014-09 and its related amendments (collectively "ASC 606") effective on January 1, 2018 using the modified retrospective method. See Note 2 for disclosure on the impact of adopting this standard.

Recent Accounting Pronouncements Not Yet Effective

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). Under the new guidance, a lessee will be required to recognize assets and liabilities for both finance, or capital, and operating leases with lease terms of more than 12 months. The ASU also will require disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. Lessor accounting will remain largely unchanged from current GAAP. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach that includes a number of optional practical expedients that entities may elect to apply. This guidance is effective for the Company beginning in the first quarter of 2019. Early adoption is permitted. The Company, upon adoption of the new guidance, will recognize operating lease liabilities and right-of-use assets for operating lease commitments covered by Topic 842, and the Company's total assets and total liabilities will increase relative to such amounts prior to adoption. The Company has gathered information and is evaluating the impact this guidance will have on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-15, Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract (ASU 2018-15), which clarifies the accounting for implementation costs in cloud computing arrangements. ASU 2018-15 is effective for the Company in the first quarter of fiscal 2020. Early adoption is permitted. The Company is currently evaluating the impact this guidance will have on its consolidated financial statements.

There are several other new accounting pronouncements issued by the FASB, which the Company will adopt. However, the Company does not believe any of those accounting pronouncements will have a material impact on its consolidated financial position, operating results or statements of cash flows.

2. ASC 606 Adoption Impact and Revenue from Contracts with Customers

ASC 606 Adoption Impact

On January 1, 2018, the Company adopted ASC 606 using the modified retrospective method, applying to all contracts. The Company recognized the cumulative effect of applying the new revenue standard as an adjustment to the opening balance of accumulated deficit at the beginning of 2018. The comparative information has not been restated and continues to be reported under the accounting standards in effect for the period presented, or "ASC 605." In connection with the adoption of ASC 606, the Company also adopted ASC 340-40, Other Assets and Deferred Costs - Contracts with Customers ("ASC 340-40"), which requires the deferral of incremental costs of obtaining a contract with a customer. Collectively, the Company refers to ASC 606 and ASC 340-40 as the "new standard."

Adoption of the new standard resulted in changes to our accounting policies for revenue recognition, commissions and deferred commissions as discussed below. The Company recorded a net reduction to opening accumulated deficit of $24.1 million as of January 1, 2018 due to the cumulative impact of adopting the new standard. The primary impact of adopting the new standard related to the deferral of $23.1 million in incremental commission costs of obtaining subscription contracts. Under ASC 605, the Company expensed all commission costs as incurred. Under the new standard, the Company defers all incremental commission costs to obtain the contract, and amortizes these costs over a period of benefit determined to be five years. The remaining $1.0 million impact of adopting the new standard related to revenue being recognized earlier than it would have been under ASC 605.

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Practical Expedients and Exemptions

The Company applies a practical expedient that permits the Company to apply ASC 340-40 to a single portfolio of contracts, as they are similar in their characteristics, and the financial statement effects of applying ASC 340-40 to that portfolio would not differ materially from applying it to the individual contracts within that portfolio.

Additionally, the Company has elected the optional exemption which allows for the exclusion of the amounts for remaining performance obligations that are part of contracts with an original expected duration of one year or less.

Impact on Condensed Consolidated Financial Statements

Select condensed consolidated balance sheet line items, which reflects the adoption impact of the new standard, are as follows:

	September 30, 2018		
(in thousands)	As Reported	Balances without adoption of ASC 606	Effect of Change Higher (Lower)
Assets:			
Accounts receivable, net	$23,903	$23,800	$ 103
Prepaid expenses and other current assets	7,962	8,042	(80)
Deferred contract acquisition costs	28,232	—	28,232
Liabilities:			
Deferred revenue - current	17,490	19,308	(1,818)
Shareholders' Equity:			
Accumulated deficit	(155,230)	(185,303)	30,073

Select condensed consolidated statement of operations line items, which reflects the adoption of the new standard, are as follows:

	Three Months Ended September 30, 2018		
(in thousands, except per share amounts)	As Reported	Balances without adoption of ASC 606	Effect of Change Higher (Lower)
Revenue	$65,304	$65,041	$ 263
Cost of revenue	26,179	26,040	139
Gross profit	39,125	39,001	124
Sales and marketing	17,818	19,574	(1,756)
Income (loss) from operations	979	(901)	1,880
Net income (loss)	(1,305)	(3,185)	1,880
Basic and diluted net loss per share	$(0.02)	$(0.05)	$ 0.03

	Nine months ended September 30, 2018		
(in thousands, except per share amounts)	As Reported	Balances without adoption of ASC 606	Effect of Change Higher (Lower)
Revenue	$185,329	$183,965	$1,364
Cost of revenue	75,695	75,165	530
Gross profit	109,634	108,800	834

Sales and marketing	53,208	58,302	(5,094)
Income (loss) from operations	1,023	(4,905)	5,928
Net income (loss)	(3,954)	(9,882)	5,928
Basic and diluted net loss per share	$(0.07)	$(0.17)	$0.10

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Select condensed consolidated cash flow line items, which reflects the adoption of the new standard, are as follows:

	Nine months ended September 30, 2018		
(in thousands)	As Reported	Balances without adoption of ASC 606	Effect of Change Higher (Lower)
Accounts receivable	$(4,931)	$(4,828)	$(103)
Prepaid expenses and other current assets	(2,755)	(2,835)	80
Deferred contract acquisition costs	(5,094)	—	(5,094)
Deferred revenue	3,910	5,728	(1,818)
Net cash provided by operating activities	23,152	23,152	—

Changes in Accounting Policies

Revenue Recognition

Revenue is recognized when control of the promised services are transferred to customers in an amount that reflects the consideration that the Company expects to receive in exchange for those services. The Company generates all of its revenue from contracts with customers. In contracts with multiple performance obligations, it identifies each performance obligation and evaluates whether the performance obligations are distinct within the context of the contract at contract inception. Performance obligations that are not distinct at contract inception are combined. The Company allocates the transaction price to each distinct performance obligation proportionately based on the estimated standalone selling price for each performance obligation. The Company then looks to how services are transferred to the customer in order to determine the timing of revenue recognition. Most services provided under the Company's agreements result in the transfer of control over time.

The Company's revenue consists of subscription services and related usage as well as professional services. The Company charges clients subscription fees, usually billed on a monthly basis, for access to the Company's Virtual Contact Center, or VCC, solution. The monthly subscription fees are primarily based on the number of agent seats, as well as the specific VCC functionalities and applications deployed by the client. Agent seats are defined as the maximum number of named agents allowed to concurrently access the VCC cloud platform. Clients typically have more named agents than agent seats. Multiple named agents may use an agent seat, though not simultaneously. Substantially all of the Company's clients purchase both subscriptions and related telephony usage. A small percentage of the Company's clients subscribe to its platform but purchase telephony usage directly from a wholesale telecommunications service provider. The Company does not sell telephony usage on a stand-alone basis to any client. The related usage fees are based on the volume of minutes used for inbound and outbound client interactions. The Company also offers bundled plans, generally for smaller deployments, whereby the client is charged a single monthly fixed fee per agent seat that includes both subscription and unlimited usage in the contiguous 48 states and, in some cases, Canada. Professional services revenue is derived primarily from VCC implementations, including application configuration, system integration, optimization, education and training services. Clients are not permitted to take possession of the Company's software.

The Company offers monthly, annual and multiple-year contracts to its clients, generally with 30 days' notice required for changes in the number of agent seats and sometimes with a minimum number of agent seats required. Larger clients typically choose annual contracts, which generally include an implementation and ramp period of several months. Fixed subscription fees (including bundled plans) are generally billed monthly in advance, while related usage fees are billed in arrears. Support activities include technical assistance for the Company's solution and upgrades and enhancements to the VCC cloud platform on a when-and-if-available basis, which are not billed separately.

The Company generally requires advance deposits from its clients based on estimated usage when such usage is not billed as part of a bundled plan. Any unused portion of the deposit is refundable to the client upon termination of the arrangement, provided all amounts due have been paid. All fees, except usage deposits, are non-refundable.

Professional services are primarily billed on a fixed-fee basis and are performed by the Company directly or, alternatively, clients may also choose to perform these services themselves or engage their own third-party service providers.

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The estimation of variable consideration for each performance obligation requires the Company to make subjective judgments resulting in estimated variable consideration that is included in the transaction fee. This is done to the extent that it is probable, in the Company's judgment, that a significant reversal in the amount of cumulative revenue recognized under the contract will not occur. The Company estimates the variable consideration in order to allocate the overall transaction fee on a relative stand-alone selling price basis to its multiple performance obligations. This requires the estimate of unit quantities, especially during the initial ramp period of the contract, during which the Company bills under an 'actual usage' model for subscription-related services.

The Company recognizes revenue on fixed fee professional services performance obligations based on the proportion of labor hours expended compared to the total hours expected to complete the related performance obligation. The determination of the total labor hours expected to complete the performance obligations involves judgment, influencing the initial stand-alone selling price estimate as well as the timing of professional services revenue recognition, although this is typically resolved in a short time frame.

When a contract with a customer is signed, the Company assesses whether collection of the fees under the arrangement is probable. The Company assesses collection based on a number of factors, including past transaction history and the creditworthiness of the client. The Company maintains a revenue reserve for potential credits to be issued in accordance with service level agreements or for other revenue adjustments.

The revenue recognition standards include guidance relating to any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer and may include, but is not limited to, sales, use, value added and excise taxes. The Company records Universal Service Fund, or USF, contributions and other regulatory costs on a gross basis in its condensed consolidated statements of operations and comprehensive loss and records surcharges and sales, use and excise taxes billed to its clients on a net basis. The cost of gross USF contributions payable to the Universal Service Administrative Company, or USAC, other FCC fund administrators and wholesale carriers is presented as a cost of revenue in the condensed consolidated statements of operations and comprehensive loss. Surcharges and sales, use and excise taxes incurred in excess of amounts billed to the Company's clients are presented in general and administrative expense in the condensed consolidated statements of operations and comprehensive loss.

Disaggregation of Revenue

The Company disaggregates its revenue by geographic region. See Note 11 for more information.

Contract Balances

The following table provides information about accounts receivable, net, deferred contract acquisition costs, contract assets and contract liabilities from contracts with customers (in thousands):

	September 30, 2018	January 1, 2018
Accounts receivable, net	$ 23,903	$19,151
Deferred contract acquisition costs:		
Current	$ 8,633	$7,059
Non-current	19,599	16,079
Total deferred contract acquisition costs	$ 28,232	$23,138
Contract assets and contract liabilities:		
Contract assets (included in prepaid expenses and other current assets)	$ 688	$736
Contract liabilities (deferred revenue)	17,490	13,568
Net contract assets (liabilities)	$ (16,802)	$(12,832)

The Company receives payments from customers based upon billing cycles. Invoice payment terms are usually 30 days or less. Accounts receivable are recorded when the right to consideration becomes unconditional.

Deferred contract acquisition costs are recorded when incurred and are amortized over a customer benefit period of five years.

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The Company's contract assets consist of unbilled amounts typically resulting from professional services revenue recognition when it exceeds the total amounts billed to the customer. The Company's contract liabilities consist of advance payments and billings in excess of revenue recognized.

In the three and nine months ended September 30, 2018, the Company recognized revenue of $1.2 million and $9.3 million, respectively, related to its contract liabilities at January 1, 2018.

Deferred Contract Acquisition Costs

In connection with the adoption of ASC 340-40, the Company capitalizes certain contract acquisition costs consisting primarily of commissions paid when contracts are signed and related incremental fringe benefits. As of January 1, 2018, the date of ASC 340-40 adoption, the Company had $23.1 million capitalized in deferred contract acquisition costs related to contracts where the benefit period had not yet expired. In the three and nine months ended September 30, 2018, amortization from amounts capitalized was $2.2 million and $6.1 million, respectively, and amounts expensed as incurred were $0.5 million and $1.5 million, respectively. As of September 30, 2018, the Company had no impairment loss in relation to costs capitalized.

Remaining Performance Obligations

As of September 30, 2018, the aggregate amount of the total transaction price allocated in contracts with original duration of greater than one year to the remaining performance obligations was $93.4 million. The Company expects to recognize revenue on approximately three-quarters of the remaining performance obligation over the next 24 months, with the balance recognized thereafter. The Company has elected the optional exemption, which allows for the exclusion of the amounts for remaining performance obligations that are part of contracts with an original expected duration of one year or less. Such remaining performance obligations represent unsatisfied or partially unsatisfied performance obligations pursuant to ASC 606.

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3. Investments and Fair Value Measurements
Marketable Investments
The Company's marketable investments have been classified and accounted for as available-for-sale. The Company's marketable investments as of September 30, 2018 were as follows (in thousands):

	September 30, 2018			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Certificates of deposit	$5,318	$ 1	$ —	$5,319
U.S. treasury	1,132	—	—	1,132
U.S. agency securities and government sponsored securities	144,208	—	(173)	144,035
Commercial paper	3,727	—	—	3,727
Municipal bonds	6,085	—	(9)	6,076
Corporate bonds	39,753	—	(35)	39,718
Total	$200,223	$ 1	$ (217)	$200,007

The following table presents the gross unrealized losses and the fair value for those marketable investments that were in an unrealized loss position as of September 30, 2018 (in thousands):

	September 30, 2018	
	Less than 12 months	
	Gross Unrealized Losses	Fair Value
U.S. treasury	$—	$1,132
U.S. agency securities and government sponsored securities	(173)	144,035
Municipal bonds	(9)	6,076
Corporate bonds	(35)	39,718
Total	$(217)	$190,961

The contractual maturities of the Company's marketable investments as of September 30, 2018 were less than one year.
Fair Value Measurements
The Company carries cash equivalents and marketable investments at fair value. Fair value is based on the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is estimated by applying the following hierarchy, which prioritizes the inputs used to measure fair value into three levels and bases the categorization within the hierarchy upon the lowest level of input that is available and significant to the fair value measurement:
Level 1 — Observable inputs which include unadjusted quoted prices in active markets for identical assets or liabilities.
Level 2 — Observable inputs other than Level 1 inputs, such as quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
Level 3 — Unobservable inputs that are supported by little or no market activity and that are based on management's assumptions, including fair value measurements determined by using pricing models, discounted cash flow methodologies or similar techniques.
The Company determined the fair value of its Level 1 financial instruments, which are traded in active markets, using quoted market prices for identical instruments.

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Marketable investments classified within Level 2 of the fair value hierarchy are valued based on other observable inputs, including broker or dealer quotations or alternative pricing sources. When quoted prices in active markets for identical assets or liabilities are not available, the Company relies on non-binding quotes from its investment managers, which are based on proprietary valuation models of independent pricing services. These models generally use inputs such as observable market data, quoted market prices for similar instruments, historical pricing trends of a security as relative to its peers. To validate the fair value determination provided by its investment managers, the Company reviews the pricing movement in the context of overall market trends and trading information from its investment managers. In addition, the Company assesses the inputs and methods used in determining the fair value in order to determine the classification of securities in the fair value hierarchy.

The following table sets forth the Company's assets measured at fair value by level within the fair value hierarchy (in thousands):

	September 30, 2018			
	Level 1	Level 2	Level 3	Total
Assets				
Cash equivalents				
Commercial paper	$—	$249	$—	$249
Money market funds	20,094	—	—	20,094
Total cash equivalents	$20,094	$249	$—	$20,343
Marketable investments				
Certificates of deposit	—	5,319	—	5,319
U.S. treasury	1,132	—	—	1,132
U.S. agency securities and government sponsored securities	—	144,035	—	144,035
Commercial paper	—	3,727	—	3,727
Municipal bonds	—	6,076	—	6,076
Corporate bonds	—	39,718	—	39,718
Total marketable investments	$1,132	$198,875	$—	$200,007

	December 31, 2017			
	Level 1	Level 2	Level 3	Total
Assets				
Cash equivalents				
Money market funds	$20,092	$—	$—	$20,092
Other Assets				
Embedded conversion option held for investment	$—	$—	$984	$984

In March 2018, the Company received proceeds of $1.9 million from the conversion and sale of a convertible note with a carrying value of $1.6 million. Proceeds from the sale of the investment totaled $2.1 million. The Company expects to receive the remainder of the proceeds in 2019.

As of September 30, 2018, the estimated fair value of the Company's outstanding 0.125% convertible senior notes due 2023 was $313.4 million. The fair value was determined based on the quoted price of the convertible senior notes in an inactive market on the last trading day of the reporting period and has been classified as Level 2 in the fair value hierarchy. See Note 6 for further information on the Company's 0.125% convertible senior notes due 2023.

There were no assets or liabilities measured at fair value on a non-recurring basis as of September 30, 2018.

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4. Financial Statement Components

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

	September 30, 2018	December 31, 2017
Cash	$ 59,276	$ 48,855
Commercial paper	249	—
Money market funds	20,094	20,092
Cash and cash equivalents	$ 79,619	$ 68,947

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

	September 30, 2018	December 31, 2017
Trade accounts receivable	$ 22,427	$ 17,481
Unbilled trade accounts receivable, net of advance client deposits	1,491	1,600
Allowance for doubtful accounts	(15)	(33)
Accounts receivable, net	$ 23,903	$ 19,048

Prepaid expenses and other current assets consisted of the following (in thousands):

	September 30, 2018	December 31, 2017
Prepaid expenses	$ 4,961	$ 2,437
Other current assets	2,313	2,403
Contract assets	688	—
Prepaid expenses and other current assets	$ 7,962	$ 4,840

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

	September 30, 2018	December 31, 2017
Computer and network equipment	$ 50,694	$ 47,195
Computer software	8,191	6,974
Internal-use software development costs	500	500
Furniture and fixtures	1,479	1,282
Leasehold improvements	804	801
Property and equipment	61,668	56,752
Accumulated depreciation and amortization	(38,759)	(36,864)
Property and equipment, net	$ 22,909	$ 19,888

Depreciation and amortization expense associated with property and equipment was $2.6 million and $7.1 million for the three and nine months ended September 30, 2018, respectively, and $1.8 million and $5.9 million for the three and nine months ended September 30, 2017, respectively.

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

	September 30, 2018	December 31, 2017
Gross	$ 47,527	$ 46,624
Less: accumulated depreciation and amortization	(31,905)	(30,438)
Total	$ 15,622	$ 16,186

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

	September 30, 2018	December 31, 2017
Accrued compensation and benefits	$ 11,787	$ 8,657
Accrued expenses	2,357	3,130
Accrued and other current liabilities	$ 14,144	$ 11,787

5. Intangible Assets

The components of intangible assets were as follows (in thousands):

	September 30, 2018			December 31, 2017		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	$2,460	$ (1,741)	$ 719	$2,460	$ (1,478)	$ 982
Customer relationships	520	(515)	5	520	(437)	83
Domain names	50	(50)	—	50	(42)	8
Total	$3,030	$ (2,306)	$ 724	$3,030	$ (1,957)	$ 1,073

Amortization expense for intangible assets was $0.1 million and $0.3 million for the three and nine months ended September 30, 2018, respectively, and $0.1 million and $0.3 million for the three and nine months ended September 30, 2017, respectively.

As of September 30, 2018, the expected future amortization expense for intangible assets was as follows (in thousands):

Period	Expected Future Amortization Expense
2018	$ 93
2019	351
2020	280
Total	$ 724

6. Debt

0.125% Convertible Senior Notes and Capped Call

In May 2018, the Company issued $225.0 million aggregate principal amount of 0.125% convertible senior notes due May 1, 2023 in a private offering and an additional $33.75 million aggregate principal amount of such notes pursuant to the exercise in full of the over-allotment option of the initial purchasers (collectively the “Notes”). The Notes are the Company’s senior unsecured obligations and bear interest at a fixed rate of 0.125% per annum, payable semiannually in arrears on May 1 and November 1 of each year, beginning on November 1, 2018. The total net proceeds from the offering, after deducting initial purchase discounts and estimated debt issuance costs, were approximately $250.7 million.

Each $1,000 principal amount of the Notes is initially convertible into 24.4978 shares of our common stock (the “Conversion Option”) which is equivalent to an initial conversion price of approximately $40.82 per share of common stock, subject to adjustment upon the occurrence of specified events. The Notes are convertible, in multiples of $1,000 principal amount, at the option of the holders at any time prior to the close of business on the business day immediately preceding November 1, 2022, only under the following circumstances: (1) during any calendar quarter commencing after the calendar quarter ending on September 30, 2018 (and only during such calendar quarter), if the last reported sale price of the Company’s common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on, and including, the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day;

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(2) during the five business day period after any five consecutive trading day period (the "Measurement Period") in which the trading price (as defined in the indenture governing the Notes) per $1,000 principal amount of Notes for each trading day of the Measurement Period was less than 98% of the product of the last reported sale price of the Company's common stock and the conversion rate in effect on each such trading day; (3) if the Company calls any or all of the Notes for redemption, at any time prior to the close of business on the second scheduled trading day immediately preceding the redemption date; or (4) upon the occurrence of specified corporate events. On or after November 1, 2022 until the close of business on the second scheduled trading day immediately preceding the maturity date, holders may convert all or any portion of their Notes, in multiples of $1,000 principal amount, at the option of the holder regardless of the foregoing circumstances.

Upon conversion, the Company will pay or deliver, as the case may be, cash, shares of the Company's common stock or a combination of cash and shares of the Company's common stock, at the Company's election. If the Company undergoes a fundamental change (as defined in the indenture governing the Notes), subject to certain conditions, holders may require the Company to repurchase for cash all or any portion of their Notes, in principal amounts of $1,000 or a multiple thereof, at a fundamental change repurchase price equal to 100% of the principal amount of the Notes to be repurchased, plus accrued and unpaid interest, if any, to, but excluding, the fundamental change repurchase date. In addition, following certain corporate events that occur prior to the maturity date or if the Company issues a notice of redemption, it will, under certain circumstances, increase the conversion rate for holders who elect to convert their Notes in connection with such corporate event or during the relevant redemption period.

During the nine months ended September 30, 2018, the conditions allowing holders of the Notes to convert were not met. The Notes were therefore not convertible during the nine months ended September 30, 2018 and were classified as long-term debt.

The Company may not redeem the Notes prior to May 5, 2021. The Company may redeem for cash all or any portion of the Notes, at its option, on or after May 5, 2021 if the last reported sale price of its common stock has been at least 130% of the conversion price then in effect for at least 20 trading days (whether or not consecutive) during any 30 consecutive trading day period (including the last trading day of such period) ending not more than two trading days immediately preceding the date on which the Company provides notice of redemption at a redemption price equal to 100% of the principal amount of the Notes to be redeemed, plus accrued and unpaid interest, if any, to, but excluding, the redemption date. No sinking fund is provided for the Notes.

The Notes are the Company's senior unsecured obligations and will rank senior in right of payment to any of the Company's indebtedness that is expressly subordinated in right of payment to the Notes; equal in right of payment to any of the Company's unsecured indebtedness that is not so subordinated; effectively junior in right of payment to any of the Company's secured indebtedness to the extent of the value of the assets securing such indebtedness; and structurally junior to all indebtedness and other liabilities (including trade payables) of the Company's subsidiaries.

In accounting for the transaction, the Notes were separated into liability and equity components. The carrying amount of the liability component was calculated by measuring the fair value of a similar debt instrument that does not have an associated conversion feature. The carrying amount of the equity component representing the conversion option was $63.8 million and was determined by deducting the fair value of the liability component from the par value of the Notes. The equity component was recorded in additional paid-in-capital and is not remeasured as long as it continues to meet the conditions for equity classification. The excess of the principal amount of the liability component over its carrying amount (the "Debt Discount") is being amortized to interest expense over the contractual term of the Notes at an effective interest rate of 6.39%.

In accounting for the debt issuance cost of $8.1 million related to the Notes, the Company allocated the total amount incurred to the liability and equity components of the Notes based on their relative values. Issuance costs attributable to the liability component were $6.1 million and are being amortized to interest expense using the effective interest method over the contractual term of the Notes. Issuance costs attributable to the equity component were netted with the equity component in additional paid-in-capital.

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The net carrying amount of the liability component of the Notes is as follows (in thousands):

	September 30, 2018
Principal	$ 258,750
Unamortized debt discount	(59,392)
Unamortized issuance costs	(5,694)
Net carrying amount	