

Zendesk, Inc.
Form 424B4
March 19, 2015
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**Filed Pursuant to Rule 424(b)(4)
Registration No. 333-202621**

8,530,000 Shares

Zendesk, Inc.

Common Stock

Zendesk, Inc. is selling 7,500,000 shares of common stock and the selling stockholders identified in this prospectus are selling 1,030,000 shares of common stock in this offering. We will not receive any proceeds from the sale of shares to be offered by the selling stockholders.

Our common stock is listed on the New York Stock Exchange under the symbol ZEN. On March 18, 2015, the last reported sale price of our common stock on the New York Stock Exchange was \$23.30 per share.

We are an emerging growth company as defined under the federal securities laws and, as such, we are subject to reduced public company reporting requirements.

See *Risk Factors* beginning on page 10 to read about factors you should consider before buying shares of common stock.

Neither the Securities and Exchange Commission nor any other regulatory body has approved or disapproved of these securities or passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

	Per Share	Total
Public offering price	\$ 22.75	\$ 194,057,500
Underwriting discount ⁽¹⁾	\$ 0.989625	\$ 8,441,501
Proceeds, before expenses, to us	\$ 21.760375	\$ 163,202,813
Proceeds, before expenses, to selling stockholders	\$ 21.760375	\$ 22,413,186

(1) See Underwriting for a description of the compensation payable to the underwriters.

The underwriters have the option to purchase up to an additional 1,279,500 shares from us at the public offering price less the underwriting discount.

The underwriters expect to deliver the shares against payment in New York, New York on March 24, 2015.

Goldman, Sachs & Co.

BofA Merrill Lynch

Pacific Crest Securities

Canaccord Genuity

Morgan Stanley

Credit Suisse

JMP Securities

Prospectus dated March 18, 2015.

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Neither we, the selling stockholders, nor any of the underwriters have authorized anyone to provide any information or to make any representations other than as contained in this prospectus or in any free writing prospectuses we have prepared. We, the selling stockholders, and the underwriters take no responsibility for, and provide no assurance as to the reliability of, any information that others may give you. This prospectus is an offer to sell only the shares offered hereby, but only under circumstances and in jurisdictions where it is lawful to do so. The information contained in this prospectus is current only as of its date.

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PROSPECTUS SUMMARY

This summary highlights selected information that is presented in greater detail elsewhere in this prospectus. This summary does not contain all of the information you should consider before investing in our common stock. You should read this entire prospectus carefully, including the sections titled Risk Factors and Management's Discussion and Analysis of Financial Condition and Results of Operations, and our consolidated financial statements and the related notes included elsewhere in this prospectus, before making an investment decision. Unless expressly indicated or the context requires otherwise, the terms Zendesk, company, we, us, and our in this prospectus refer to Zendesk, Inc., a Delaware corporation, and its consolidated subsidiaries.

Overview

Zendesk believes the fundamental relationship between organizations and their customers is changing, and a new customer service philosophy is emerging.

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

Our business model is designed to drive organic growth, leverage positive word-of-mouth, and remove friction from the evaluation and purchasing process. A substantial percentage of our customers find us online and subscribe to our customer service platform directly from our website. Exemplifying the success of our sales and marketing strategy, during the three months ended December 31, 2014, approximately 64% of our qualified sales leads generated online, and approximately 62% of the total qualified sales leads for our customer service platform, came from organic search, customer referrals, and other unpaid sources. Our largest source of qualified sales leads is free trials of our customer service platform commenced by prospects. Our sales team largely focuses on a land and expand strategy, which leverages this grassroots adoption and seeks to expand our footprint within organizations.

As of December 31, 2014, we had approximately 52,500 paid customer accounts on our customer service platform and live chat software in the aggregate, which represent organizations across a broad array of sizes, industries, and geographies. Our customers are located in 150 countries and territories and provide customer service through our platform in over 40 languages.

In March 2014, we completed the acquisition of Zopim Technologies Pte Ltd., or Zopim, a software development company that provides a SaaS live chat service. Through Zopim, we provide live chat software as a standalone service and as an integrated service with our customer service platform for chat-enabled agents.

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Our financial performance reflects our significant customer growth and strong customer retention and expansion. For the years ended December 31, 2012, 2013, and 2014, our revenue was \$38.2 million, \$72.0 million, and \$127.0 million, respectively, representing an 88% annual growth rate from 2012 to 2013 and a 76% annual growth rate from 2013 to 2014. For the years ended December 31, 2012, 2013, and 2014, we derived \$15.8 million, or 41%, \$29.6 million, or 41%, and \$54.8 million, or 43%, respectively, of our revenue from customers located outside of the United States. For the years ended December 31, 2012, 2013, and 2014, we generated net losses of \$24.4 million, \$22.6 million, and \$67.4 million, respectively. We intend to continue to invest aggressively to drive continued growth and market leadership.

Industry Background

Over the last several years, the ways in which people research, purchase from, and communicate with organizations have evolved from a relatively simple set of interactions into a rapidly expanding network of information and communications. The result is people who are better informed about the products and services they buy; have more choices and potentially less loyalty; and can influence many others with their opinions. People have higher expectations about how an organization will relate to them and less patience for organizations that do not meet these expectations.

We believe this transformation creates tremendous opportunities for organizations of all sizes that make customer service a critical focus of their operations. We believe that many successful organizations today exemplify this new approach and have discovered that a deep understanding of the customer experience can be the foundation for building highly valuable customer relationships. While opportunities abound for organizations that recognize and capitalize on these trends, the penalties for failing to evolve to this changing landscape can be severe. Acting as brand advocates or adversaries, individuals can influence peers' opinions and purchasing behavior.

Various software tools, delivered both on-premise and in the cloud, have attempted to address the difficult nature of customer support for many years. This legacy customer support software is costly and complex, causing the vast majority of small and medium-sized businesses, or SMBs, to rely primarily on tools like email, phones, and spreadsheets. Even larger organizations able to afford customer support software often adopt a piecemeal approach with the goal of minimizing support costs. The result is the inability to support multiple channels or expand to new channels, ultimately leading to customer frustration.

Legacy customer support software also limits employees' effectiveness in responding to customer inquiries and offers few, if any, analytics, recommendations, or performance benchmarks. Familiar with consumer web software like Facebook, Twitter, and Gmail, employees desire tools with similar ease-of-use and sophistication. Most enterprise software, particularly customer support software, has not progressed to embrace consumer design tactics including optimized user experience, availability on personal devices, and ease-of-deployment.

We believe that effective customer service requires a purpose-built platform that embraces the new landscape of omni-channel communication and the empowered and informed customer, and places an emphasis on well-designed experiences.

According to International Data Corporation, or IDC, a global market intelligence firm, in 2013 the worldwide customer relationship management, or CRM, software market comprised \$22.8 billion. Our customer service platform primarily addresses the customer service and contact center segments which comprised a total of \$10.5 billion in 2013 worldwide. In addition, IDC has estimated that between 2012 and 2017 SaaS solutions in the overall CRM applications market will grow over ten times faster.

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than legacy on-premise solutions. In a 2013 report, IDC also estimated that there were approximately 76 million SMBs worldwide. We believe that many of these organizations have not been able to implement or afford legacy customer support software and therefore represent a substantial greenfield market opportunity for our customer service platform.

The Zendesk Approach

Zendesk's mission is to help organizations and their customers build better relationships. Our intuitive customer service platform facilitates listening to the customer, finding the best possible answer, communicating through the appropriate channel, and sharing the knowledge gained with the whole organization.

Beautifully Simple. We have an overarching philosophy to be beautifully simple. We take intuitive design elements that people have grown to expect from consumer software and incorporate them into our platform. We also offer a free trial and a transparent purchase process with numerous self-service options that are suitable for SMBs and enterprise departments as well as assisted options for larger clients.

Omni-Channel and Contextual. Our customer service platform is built to support customers across a wide variety of integrated channels – email, voice, social media, and websites. We offer live chat as a standalone service and as an integrated service with our customer service platform for chat-enabled agents. In addition, our customer service platform provides important contextual information around customer issues by encouraging employee collaboration and enabling real-time information sharing.

Affordable. We believe our subscription plans are significantly less expensive and offer greater pricing transparency than many legacy customer support software applications (especially when software updates, ongoing maintenance, and consultant fees required for integration, installation, customization, and training are taken into account).

Natively Mobile. Through native mobile apps, employees can access our platform anywhere with robust product functionality, an elegant interface, and performance analytics.

Cloud-Based Architecture. Our architecture automates frequent software updates and introduction of new features while also allowing our platform to easily scale within organizations. Configurations made with simple tools tailor the functionality and design of our platform to an organization's particular needs and keep customer service efforts of any size organized.

Open Platform. Our platform includes over 270 pre-built integrations with CRM, e-commerce, telephony, live chat, and other apps, which are enabled through our app marketplace. Developed with our open application programming interfaces, or APIs, our platform can also be customized, integrated, or expanded upon with private apps. Through Zendesk Embeddables, we enable customers to simply and natively integrate critical functionality directly into their own websites and applications, including optimized integrations for mobile applications.

Proactive Engagement. Organizations are equipped to proactively communicate with customers at the most relevant and critical moments. For example, organizations can automatically trigger workflow to proactively reach out to customers that may signal they have had a bad experience or need particular attention.

Strategic Analytics. Our customer service platform provides analytics that are mission critical for an organization's operations. In all subscription plans for our customer service platform, managers have access to real-time operational efficiency and customer satisfaction analytics at the interaction, agent, and organizational level.

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Growth Strategy

We are focused on the following key areas of growth:

Introducing new products and broadening our platform functionality;

Furthering our data-driven approach;

Maintaining our leadership in the SMB market;

Expanding our enterprise customer base;

Continuing to increase our global customer footprint;

Broadening our integrations and partnerships; and

Developing our brand.

Risk Factors Summary

Our business is subject to numerous risks and uncertainties, including those highlighted in the section titled **Risk Factors** immediately following this prospectus summary. These risks include, but are not limited to, the following:

We may fail to adapt our customer service platform, from which we derive substantially all of our revenue and cash flows, to changing market dynamics and customer preferences or achieve increased market acceptance of our platform;

We have a history of losses and we expect our revenue growth rate to decline; as our costs increase, we may not be able to generate sufficient revenue to achieve or sustain profitability;

We have a limited operating history, which makes it difficult to evaluate our prospects and future operating results;

We may not be able to develop enhancements to our customer service platform and live chat software that achieve market acceptance or that keep pace with technological developments;

We may fail to effectively manage our growth and organizational change in a manner that preserves the key aspects of our culture;

The market in which we participate is intensely competitive, and we may not compete effectively;

The market for SaaS business software applications may develop more slowly than we expect or decline;

If we are not successful in selling live chat software as a standalone service or more fully integrating our live chat software with our customer service platform, our business could be harmed;

Our network or computer systems may be breached or unauthorized access to customer data may otherwise be obtained, causing our platform to be perceived as insecure;

We may experience service interruptions or performance problems associated with our technology and infrastructure;

Real or perceived errors, failures, or bugs in our customer service platform or live chat software may occur;

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We depend substantially on our customers renewing their subscriptions and purchasing additional subscriptions from us and we may suffer declines in our customer retention or expansion;

We may fail to effectively expand our sales capabilities; and

Our stock price may be volatile or may decline regardless of our operating performance.

General Corporate Information

We were founded in Copenhagen, Denmark in 2007. We reincorporated in Delaware in 2009. Our principal executive offices are located at 1019 Market Street, San Francisco, California 94103, and our telephone number is (415) 418-7506. Our website address is www.zendesk.com. Information contained on or that can be accessed through our website does not constitute part of this prospectus and inclusions of our website address in this prospectus are inactive textual references only.

Zendesk, Zopim, the Lotus flower image, and other trademarks or service marks of Zendesk appearing in this prospectus are the property of Zendesk or its consolidated subsidiaries. This prospectus contains additional trade names, trademarks, and service marks of other companies. We do not intend our use or display of other companies trade names, trademarks or service marks to imply a relationship with, or endorsement or sponsorship of us by, these other companies.

Implications of Being an Emerging Growth Company

As a company with less than \$1.0 billion in revenue during our last fiscal year, we qualify as an emerging growth company as defined in the Jumpstart Our Business Startups Act of 2012, or the JOBS Act. An emerging growth company may take advantage of specified reduced reporting requirements that are otherwise applicable generally to public companies. These provisions include:

an exemption from compliance with the auditor attestation requirement on the effectiveness of our internal control over financial reporting;

an exemption from compliance with any requirement that the Public Company Accounting Oversight Board may adopt regarding mandatory audit firm rotation or a supplement to the auditor's report providing additional information about the audit and the financial statements;

reduced disclosure about our executive compensation arrangements; and

exemptions from the requirements to obtain a non-binding advisory vote on executive compensation or a stockholder approval of any golden parachute arrangements.

We will remain an emerging growth company until the earliest to occur of: the last day of the fiscal year in which we have more than \$1.0 billion in annual revenue; the end of the fiscal year in which the market value of our common stock that is held by non-affiliates exceeds \$700 million as of the end of the second quarter of that fiscal year; the

issuance, in any three-year period, by us of more than \$1.0 billion in non-convertible debt securities; and the last day of the fiscal year ending after the fifth anniversary of our initial public offering, or IPO. We may choose to take advantage of some, but not all, of the available benefits under the JOBS Act. We have chosen to irrevocably opt out of the extended transition periods available under the JOBS Act for complying with new or revised accounting standards, but we intend to take advantage of certain of the other exemptions discussed above. Accordingly, the information contained herein may be different than the information you receive from other public companies in which you hold stock.

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THE OFFERING

Common stock offered by us	7,500,000 shares
Common stock offered by the selling stockholders	1,030,000 shares
Common stock to be outstanding after this offering	83,097,076 shares
Option to purchase additional shares from us	We have granted the underwriters an option, exercisable for 30 days after the date of this prospectus, to purchase up to an additional 1,279,500 shares from us.
Use of proceeds	<p>The principal purposes of this offering are to raise additional capital and facilitate an orderly distribution of shares for the selling stockholders. We estimate that the net proceeds from the sale of shares of our common stock that we are selling in this offering will be approximately \$162.3 million (or approximately \$190.1 million if the underwriters' option to purchase additional shares in this offering is exercised in full), based on the public offering price of \$22.75 per share, and after deducting underwriting discounts and commissions and estimated offering expenses payable by us. We will not receive any proceeds from the sale of shares by the selling stockholders.</p> <p>We intend to use the net proceeds that we receive from this offering for working capital or other general corporate purposes, including the further expansion and development of our customer service platform and live chat software, the development of new products and services, continued expansion of our sales and marketing capabilities, and international expansion. We may also use a portion of the net proceeds to acquire complementary businesses, products, services, or technologies. However, we have not entered into any</p>

agreements or commitments for any specific acquisitions at this time.

See the section titled "Use of Proceeds" for additional information.

Concentration of ownership

Upon the completion of this offering, our executive officers and directors and stockholders holding more than 5% of our capital stock, and their affiliates, will beneficially own, in the aggregate, approximately 47.6% of our outstanding shares of common stock.

NYSE trading symbol

ZEN

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The number of shares of common stock that will be outstanding after this offering is based on 75,577,076 shares outstanding as of December 31, 2014 and 20,000 shares to be issued upon exercise of an option to purchase common stock by a certain selling stockholder and sold in this offering, and excludes:

12,044,546 shares of our common stock issuable upon the exercise of options to purchase common stock that were outstanding as of December 31, 2014 with a weighted-average exercise price of \$7.39 per share (other than 20,000 shares to be issued upon exercise of an option to purchase common stock by a certain selling stockholder and sold in this offering);

3,063,455 shares of our common stock subject to restricted stock units outstanding as of December 31, 2014;

1,318,800 shares of our common stock issuable upon the exercise of options to purchase common stock granted after December 31, 2014 through February 28, 2015, with a weighted-average exercise price of \$24.75 per share;

1,852,932 shares of our common stock subject to restricted stock units granted after December 31, 2014 through February 28, 2015;

7,559,573 shares of our common stock reserved for future issuance under our 2014 Stock Option and Incentive Plan as of December 31, 2014;

3,197,419 shares of our common stock reserved for future issuance under our 2014 Employee Stock Purchase Plan as of December 31, 2014; and

any shares of our common stock that become available subsequent to this offering under our 2014 Stock Option and Incentive Plan and 2014 Employee Stock Purchase Plan pursuant to provisions thereof that automatically increase the share reserves under such plans each year, as more fully described in Executive Compensation Employee Benefit and Stock Plans.

Except as otherwise indicated, all information in this prospectus assumes no exercise by the underwriters of their option to purchase up to an additional 1,279,500 shares of common stock from us in this offering.

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The following consolidated statements of operations for the years ended December 31, 2012, 2013, and 2014 and the summary consolidated balance sheet data as of December 31, 2014 are derived from the audited consolidated financial statements that are included elsewhere in this prospectus. Our historical results are not necessarily indicative of the results to be expected in the future. You should read the following summary consolidated financial data below in conjunction with the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and related notes included elsewhere in this prospectus.

	Year Ended December 31,		
	2012	2013	2014
	(In thousands, except per share data)		
Consolidated Statements of Operations:			
Revenue	\$ 38,228	\$ 72,045	\$ 127,049
Cost of revenue ⁽¹⁾	13,253	24,531	46,047
Gross profit	24,975	47,514	81,002
Operating expenses ⁽¹⁾			
Research and development	14,816	15,288	36,403
Sales and marketing	22,749	37,622	77,875
General and administrative	11,558	16,437	32,869
Total operating expenses	49,123	69,347	147,147
Operating loss	(24,148)	(21,833)	(66,145)
Other expense, net	(96)	(517)	(1,533)
Loss before provision for (benefit from) income taxes	(24,244)	(22,350)	(67,678)
Provision for (benefit from) income taxes	121	221	(263)
Net loss	(24,365)	(22,571)	(67,415)
Accretion of redeemable convertible preferred stock	(50)	(49)	(18)
Deemed dividend to investors in relation to the tender offer	(8,326)		
Net loss attributable to common stockholders	\$ (32,741)	\$ (22,620)	\$ (67,433)
Net loss per share attributable to common stockholders, basic and diluted ⁽²⁾	\$ (1.67)	\$ (1.04)	\$ (1.26)
Weighted-average shares used to compute net loss per share attributable to common stockholders, basic and diluted ⁽²⁾	19,629	21,674	53,571

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

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

- (2) See Note 10 of the Notes to our Consolidated Financial Statements included elsewhere in this prospectus for an explanation of the method used to calculate basic and diluted net loss per share attributable to common stockholders and the weighted-average number of shares used in the computation of the per share amounts.

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	As of December 31, 2014	
	Actual	As Adjusted⁽¹⁾
	(In thousands)	
	(Unaudited)	
Consolidated Balance Sheet Data:		
Cash and cash equivalents	\$ 80,265	\$ 242,543
Marketable securities	42,204	42,204
Working capital	60,856	223,134
Property and equipment, net	41,895	41,895
Goodwill and intangible assets, net	14,152	14,152
Total assets	205,788	368,066
Deferred revenue	51,731	51,731
Credit facility	6,952	6,952
Total liabilities	92,082	92,082
Stockholders' equity	113,706	275,984

- (1) The as adjusted balance sheet data in the table above reflects (A) the sale of 7,500,000 shares of our common stock in this offering by us at the public offering price of \$22.75 per share, and after deducting underwriting discounts and commissions and estimated offering expenses payable by us, and (B) the issuance of 20,000 shares of common stock to be acquired by a certain selling stockholder upon the exercise of options in order to sell those shares in the offering.

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RISK FACTORS

Investing in our common stock involves a high degree of risk. Before you invest in our common stock, you should carefully consider the following risks, together with all of the other information contained in this prospectus, including our financial statements and related notes, before making a decision to invest in our common stock. Any of the following risks could have a material adverse effect on our business, operating results, and financial condition and could cause the trading price of our common stock to decline, which would cause you to lose all or part of your investment.

Risks Related to Our Business

We derive, and expect to continue to derive, substantially all of our revenue and cash flows from our customer service platform. If we fail to adapt this platform to changing market dynamics and customer preferences or to achieve increased market acceptance of our customer service platform, our business, results of operations, financial condition, and growth prospects would be harmed.

We derive, and expect to continue to derive, substantially all of our revenue and cash flows from sales of subscriptions to our customer service platform. As such, the market acceptance of this platform is critical to our success. Demand for our customer service platform is affected by a number of factors, many of which are beyond our control, such as continued market acceptance of our platform by customers for existing and new use cases, the timing of development and release of new products, features, and functionality introduced by our competitors, technological change, and growth or contraction in our addressable market. We expect that an increasing focus on customer satisfaction and the growth of various communications channels will profoundly impact the market for customer support software and blur distinctions between traditionally separate systems for customer support, marketing automation, and customer relationship management, enabling new competitors to emerge. If we are unable to meet customer demands to manage customer experiences through flexible solutions designed to address all these needs or otherwise achieve more widespread market acceptance of our customer service platform, our business, results of operations, financial condition, and growth prospects will be adversely affected.

We have a history of losses and we expect our revenue growth rate to decline. As our costs increase, we may not be able to generate sufficient revenue to achieve and sustain our profitability.

We have incurred net losses in each year since our inception, including net losses of \$24.4 million, \$22.6 million, and \$67.4 million for the fiscal years ended December 31, 2012, 2013, and 2014, respectively. We incurred net losses of \$6.1 million and \$17.5 million in the three months ended December 31, 2013 and 2014, respectively. We had an accumulated deficit of \$131.9 million at December 31, 2014. For the three months ended December 31, 2013 and 2014, our revenue was \$22.5 million and \$38.5 million, respectively, representing a 71% growth rate. For the fiscal years ended December 31, 2012, 2013, and 2014, our revenue was \$38.2 million, \$72.0 million, and \$127.0 million, respectively, representing a 76% growth rate. We expect that our revenue growth rate will decline over time. We may not be able to generate sufficient revenue to achieve and sustain profitability as we also expect our costs to increase in future periods. We expect to continue to expend substantial financial and other resources on:

development of our customer service platform, including investments in our research and development team, the development or acquisition of new products, features and functionality, and improvements to the scalability, availability, and security of our customer service platform;

our technology infrastructure, including expansion of our activities in our self-managed colocation data centers, enhancements to our network operations and infrastructure, and hiring of additional employees for our operations team;

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sales and marketing, including a significant expansion of our direct sales organization;

additional international expansion in an effort to increase our customer base and sales; and

general administration, including legal, accounting, and other expenses related to our obligations as a public company.

These investments may not result in increased revenue or growth of our business. If we fail to continue to grow our revenue, our operating results, and business would be harmed.

We have a limited operating history, which makes it difficult to evaluate our prospects and future operating results.

We incorporated and first launched our customer service platform in 2007. As a result of our limited operating history, our ability to forecast our future operating results is limited and subject to a number of uncertainties, including our ability to plan for and model future growth. Our historical revenue growth has been inconsistent, and should not be considered indicative of our future performance. Further, in future periods, our revenue could decline for a number of reasons, including any reduction in demand for our customer service platform or live chat software, increased competition, contraction of our overall market, or our failure, for any reason, to capitalize on growth opportunities. We have encountered and will encounter risks and uncertainties frequently experienced by growing companies in rapidly changing industries, such as the risks and uncertainties described herein. If our assumptions regarding these risks and uncertainties, which we use to plan our business, are incorrect or change, or if we do not address these risks successfully, our operating and financial results could differ materially from our expectations, and our business could suffer.

If we are not able to develop enhancements to our customer service platform or live chat software that achieve market acceptance and that keep pace with technological developments, our business would be harmed.

Our ability to attract new customers and increase revenue from existing customers depends in large part on our ability to enhance and improve our customer service platform and live chat software and to introduce new products and services. In order to grow our business, we must develop products and services that reflect the changing nature of customer service, and expand beyond customer service to other areas of managing relationships with customers. The success of any enhancement to our customer service platform or live chat software depends on several factors, including timely completion, adequate quality testing, and market acceptance. Any new product or service that we develop may not be introduced in a timely or cost-effective manner, may contain defects, or may not achieve the market acceptance necessary to generate sufficient revenue. If we are unable to successfully develop new products or services, enhance our existing customer service platform and live chat software to meet customer requirements or otherwise gain market acceptance, our business and operating results will be harmed.

Because our customer service platform and live chat software are available over the Internet, we need to continuously modify and enhance them to keep pace with changes in Internet-related hardware, software, communications, and database technologies and standards. If we are unable to respond in a timely and cost-effective manner to these rapid technological developments and changes in standards, our customer service platform and live chat software may become less marketable, less competitive, or obsolete, and our operating results will be harmed.

If we fail to effectively manage our growth and organizational change in a manner that preserves the key aspects of our culture, our business and operating results could be harmed.

We have experienced and may continue to experience rapid growth and organizational change, which has placed, and may continue to place, significant demands on our management, operational,

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and financial resources. For example, our headcount has grown from 473 employees on December 31, 2013 to 806 employees on December 31, 2014. In addition, we have established subsidiaries in Denmark, the United Kingdom, Australia, Ireland, Japan, the Philippines, and Brazil since our inception in 2007, and, as a result of the acquisition of Zopim, we also have a subsidiary in Singapore. We may continue to expand our international operations into other countries in the future. We have also experienced significant growth in the number of customers, end users, transactions, and data that our customer service platform and our associated hosting infrastructure support. Finally, our organizational structure is becoming more complex and we may need to scale and adapt our operational, financial, and management controls, as well as our reporting systems and procedures to manage this complexity. We will require significant capital expenditures and the allocation of valuable management resources to grow and change in these areas without undermining our corporate culture of rapid innovation, simplicity in design, and attention to customer satisfaction that has been critical to our growth so far. If we fail to manage our anticipated growth and change in a manner that preserves the key aspects of our culture, the quality of our products and services may suffer, which could negatively affect our brand and reputation and harm our ability to retain and attract customers.

The market in which we participate is intensely competitive, and if we do not compete effectively, our operating results could be harmed.

The market for customer service solutions is fragmented, rapidly evolving, and highly competitive, with relatively low barriers to entry. Among the small to medium sized organizations that make up a large proportion of our customers, we often compete with general use computer applications and other tools, which these organizations use to provide support and which can be deployed for little or no cost. These include shared accounts for email communication, phone banks for voice communication, and pen and paper, text editors, and spreadsheets for tracking and management. With respect to larger organizations and enterprises seeking to deploy a customer service software system, we have many competitors that are larger and which have greater name recognition, much longer operating histories, more established customer relationships, larger marketing budgets, and significantly greater resources than we do.

Our competitors may be able to respond more quickly and effectively than we can to new or changing opportunities, technologies, standards, or customer requirements. With the introduction of new technologies, the evolution of our platform, and new market entrants, we expect competition to intensify in the future. Pricing pressures and increased competition generally could result in reduced sales, reduced margins, losses, or the failure of our platform to achieve or maintain more widespread market acceptance, any of which could harm our business.

We face competition from in-house software systems, large integrated systems vendors, and smaller companies offering alternative SaaS applications. Our competitors vary in size and in the breadth and scope of the products and services they offer. We face substantial competition from salesforce.com, Inc., Oracle Corporation, Verint Systems, Inc., and Microsoft Corporation, each of which can bundle competing products and services with other software offerings, or offer them at a low price as part of a larger sale. In addition, we compete with a number of other SaaS providers with focused customer support applications, including desk.com (a salesforce.com service), Kayako Helpdesk Pvt. Ltd., Freshdesk, Inc., Brightwurks, Inc. (Help Scout), SupportBee, Inc., and Tenmiles Technologies Pvt. Ltd. (Happy Fox), many of which offer free or significantly discounted prices for their services. For organizations seeking software to support employee service and other internal use cases, we compete with companies such as ServiceNow, Inc., BMC Software, Inc., Atlassian Pty Ltd, and Hewlett-Packard Company. We also compete with a number of providers of live chat software, including LivePerson, Inc, BoldChat (a LogMeIn, Inc. service), Velaro, Inc., SnapEngage, LLC, Habla, Inc. (Olark), and LiveChat, Inc. Further, other established SaaS providers not currently focused on customer support or live chat software may expand their services to compete with us. Many of our

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current and potential competitors have established marketing relationships, access to larger customer bases, pre-existing customer relationships, and major distribution agreements with consultants, system integrators, and resellers. Additionally, some potential customers, particularly large organizations, have elected, and may in the future elect, to develop their own internal customer support software system. Certain of our competitors have partnered with, or have acquired, and may in the future partner with or acquire, other competitors to offer services, leveraging their collective competitive positions, which makes, or would make, it more difficult to compete with them. For all of these reasons, we may not be able to compete successfully against our current and future competitors, which would harm our business.

If the market for SaaS business software applications develops more slowly than we expect or declines, our business would be adversely affected.

The market for SaaS business software applications is less mature than the market for on-premise business software applications, and the adoption rate of SaaS business software applications may be slower among subscribers in industries with heightened data security interests or business practices requiring highly customizable application software. Our success will depend to a substantial extent on the widespread adoption of SaaS business applications in general, and of SaaS customer service applications in particular. Many organizations have invested substantial personnel and financial resources to integrate traditional on-premise business software applications into their businesses, and therefore may be reluctant or unwilling to migrate to SaaS applications. It is difficult to predict customer adoption rates and demand for our customer service platform and live chat software, the future growth rate and size of the SaaS business applications market or the entry of competitive applications. The expansion of the SaaS business applications market depends on a number of factors, including the cost, performance, and perceived value associated with SaaS, as well as the ability of SaaS providers to address data security and privacy concerns. Additionally, government agencies have adopted, or may adopt, laws and regulations regarding the collection, use, and transfer of personal information obtained from consumers and other individuals, or may seek to access information on our platform, either of which may reduce the overall demand for our platform. If we or other SaaS providers experience data security incidents, loss of customer data, disruptions in delivery, or other problems, the market for SaaS business applications, including our customer service platform and live chat software, may be negatively affected. If SaaS business applications do not continue to achieve market acceptance, or there is a reduction in demand for SaaS business applications caused by a lack of customer acceptance, technological challenges, weakening economic conditions, data security or privacy concerns, governmental regulation, competing technologies and products, or decreases in information technology spending, it would result in decreased revenue and our business would be adversely affected.

If we are not successful in selling our live chat software as a standalone service or more fully integrating our live chat software with our customer service platform, our business could be harmed.

As a result of the acquisition of Zopim, we now sell our live chat software as a standalone service. Our live chat software can also be integrated with our customer service platform as a means to enable live chat functionality for agents and this integration is now the primary means by which we offer chat functionality on our customer service platform.

We have limited experience selling separate products in general or live chat software in particular, and as a result, our live chat software may not gain acceptance with our customers and potential customers.

Our reliance on our live chat software as a primary means of enabling chat functionality in connection with our customer service platform may not be successful. In particular, we currently charge

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a separate subscription fee per chat-enabled agent. While we believe our live chat software represents a substantial upgrade in functionality over the chat functionality historically embedded in our customer service platform, our current or prospective customers may resist paying for functionality that, to some degree, was previously available to all agents under a single subscription to our customer service platform. If our customers do not purchase our live chat software as a standalone service or as integrated with our customer service platform, our business, revenue, and operating results could be harmed.

If our network or computer systems are breached or unauthorized access to customer data is otherwise obtained, our customer service platform and live chat software may be perceived as insecure, we may lose existing customers or fail to attract new customers, and we may incur significant liabilities.

Use of our customer service platform and live chat software involve the storage, transmission, and processing of our customers' proprietary data, including personal or identifying information regarding their customers or employees. Unauthorized access to or security breaches of our customer service platform or live chat software could result in the loss of data, loss of intellectual property or trade secrets, loss of business, severe reputational damage adversely affecting customer or investor confidence, regulatory investigations and orders, litigation, indemnity obligations, damages for contract breach, penalties for violation of applicable laws, regulations, or contractual obligations, and significant costs for remediation that may include liability for stolen assets or information and repair of system damage that may have been caused, incentives offered to customers or other business partners in an effort to maintain business relationships after a breach, and other liabilities. Notifications related to a security breach regarding or pertaining to any of such service providers could impact our reputation, harm customer confidence, hurt our sales and expansion into new markets, or cause us to lose existing customers. We have incurred and expect to incur significant expenses to prevent, investigate, and remediate security breaches and vulnerabilities, including deploying additional personnel and protection technologies, training employees, and engaging third-party experts and consultants. Our errors and omissions insurance coverage covering certain security and privacy damages and claim expenses may not be sufficient to compensate for all liability.

We have experienced significant breaches and identified significant vulnerabilities of our security measures and the security measures deployed by third-party vendors upon which we rely and our customer service platform and live chat software are at risk for future breaches as a result of third-party action, employee, vendor, or contractor error, malfeasance, or other factors. For example, in February 2013, we experienced a security breach involving unauthorized access to three of our customers' accounts and personal information of consumers maintained in those customer accounts.

We have only been offering our live chat software since the completion of our acquisition of Zopim in March 2014. The systems, networks, personnel, equipment, and vendors utilized to provide our live chat software have historically been separate from those utilized in connection with our customer service platform and have not been subject to the same security reviews and assessments as those used to provide our customer service platform. Our failure to complete these assessments and implement improvements to the security measures deployed to protect our live chat software in a timely manner could increase our risk of a security breach with respect to this service, which would harm our business as a whole.

Because the techniques used and vulnerabilities exploited to obtain unauthorized access or to sabotage systems change frequently and generally are not identified until they are launched against a target, we may be unable to anticipate these techniques or vulnerabilities or implement adequate preventative measures. We may also experience security breaches that may remain undetected for an extended period.

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Because data security is a critical competitive factor in our industry, we make numerous statements in our privacy policies and terms of service, through our certifications to privacy standards, and in our marketing materials, providing assurances about the security of our customer service platform and live chat software including detailed descriptions of security measures we employ. Should any of these statements be untrue or become untrue, even through circumstances beyond our reasonable control, we may face claims of misrepresentation or deceptiveness by the U.S. Federal Trade Commission, state and foreign regulators, and private litigants.

Interruptions or performance problems associated with our technology and infrastructure may adversely affect our business and operating results.

Our continued growth depends in part on the ability of our existing and potential customers to access our customer service platform and live chat software at any time and within an acceptable amount of time. Our customer service platform and live chat software are proprietary, and we rely on the expertise of members of our engineering, operations, and software development teams for their continued performance. We have experienced, and may in the future experience, disruptions, outages, and other performance problems due to a variety of factors, including infrastructure changes, introductions of new functionality, human or software errors, capacity constraints due to an overwhelming number of users accessing our customer service platform or live chat software simultaneously, distributed denial of service attacks, or other security related incidents. In some instances, we may not be able to identify the cause or causes of these performance problems within an acceptable period of time. It may become increasingly difficult to maintain and improve our performance, especially during peak usage times and as our customer service platform and live chat software become more complex and our user traffic increases. If our customer service platform or live chat software is unavailable or if our users are unable to access our customer service platform or live chat software within a reasonable amount of time or at all, our business would be negatively affected. In addition, our infrastructure does not currently support the real-time mirroring of data. Therefore, in the event of any of the factors described above, or certain other failures of our infrastructure, customer data may be permanently lost. Moreover, some of our customer agreements and certain subscription plans include performance guarantees and service level standards that obligate us to provide credits or termination rights in the event of a significant disruption in our platform. To the extent that we do not effectively address capacity constraints, upgrade our systems as needed, and continually develop our technology and network architecture to accommodate actual and anticipated changes in technology, our business and operating results may be adversely affected.

Real or perceived errors, failures, or bugs in our customer service platform or live chat software could adversely affect our operating results and growth prospects.

Because our customer service platform and live chat software are complex, undetected errors, failures, vulnerabilities, or bugs may occur, especially when updates are deployed. Our customer service platform and live chat software are often used in connection with large-scale computing environments with different operating systems, system management software, equipment, and networking configurations, which may cause errors or failures of our customer service platform, our live chat software, or other aspects of the computing environment into which they are deployed. In addition, deployment of our customer service platform or live chat software into complicated, large-scale computing environments may expose undetected errors, failures, vulnerabilities, or bugs in our customer service platform or live chat software. We have discovered and expect will continue to discover software errors, failures, vulnerabilities, and bugs in our customer service platform and live chat software, some of which have or may only be discovered and remediated after deployment to customers. Real or perceived errors, failures, vulnerabilities, or bugs in our customer service platform or live chat software could result in negative publicity, loss of or delay in market acceptance of our customer service platform or live chat software, loss of competitive position, or claims by customers for

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losses sustained by them. In such an event, we may be required, or may choose, for customer relations or other reasons, to expend additional resources in order to help correct the problem.

Incorrect or improper implementation or use of our customer service platform or live chat software could result in customer dissatisfaction and negatively affect our business, results of operations, financial condition, and growth prospects.

Our customer service platform and live chat software are deployed in a wide variety of technology environments and into a broad range of complex workflows. Increasingly, our customer service platform and live chat software have been integrated into large-scale, complex technology environments, and specialized use cases, and we believe our future success will depend on our ability to increase use of our customer service platform and live chat software in such deployments. We often assist our customers in implementing our customer service platform and live chat software, but many customers attempt to implement even complex deployments themselves. If we or our customers are unable to implement our customer service platform or live chat software successfully, or unable to do so in a timely manner, customer perceptions of our customer service platform, our live chat software, and company may be impaired, our reputation and brand may suffer, and customers may choose not to renew or expand the use of our customer service platform or live chat software.

Our customers and third-party partners may need training in the proper use of our customer service platform or live chat software to maximize its potential. If our customer service platform or live chat software is not implemented or used correctly or as intended, inadequate performance may result. Because our customers rely on our customer service platform to manage a wide range of operations, the incorrect or improper implementation or use of our customer service platform, our failure to train customers on how to efficiently and effectively use our customer service platform, or our failure to provide adequate product support to our customers, may result in negative publicity or legal claims against us. Also, as we continue to expand our customer base, any failure by us to properly provide these services will likely result in lost opportunities for additional subscriptions to our customer service platform and live chat software.

Any failure to offer high-quality product support may adversely affect our relationships with our customers and our financial results.

In deploying and using our customer service platform and live chat software, our customers depend on our product support team to resolve complex technical and operational issues. We may be unable to respond quickly enough to accommodate short-term increases in customer demand for product support. We also may be unable to modify the nature, scope, and delivery of our product support to compete with changes in product support services provided by our competitors. Increased customer demand for product support, without corresponding revenue, could increase costs and adversely affect our operating results. Our sales are highly dependent on our business reputation and on positive recommendations from our existing customers. Any failure to maintain high-quality product support, or a market perception that we do not maintain high-quality product support, could adversely affect our reputation, our ability to sell our customer service platform and live chat software to existing and prospective customers, our business, operating results, and financial position.

We depend on our executive officers and other key employees and the loss of one or more of these employees or an inability to attract and retain highly skilled employees could adversely affect our business.

Our success depends largely upon the continued services of our executive officers and other key employees. We rely on our leadership team in the areas of research and development, operations, security, marketing, sales, support, general and administrative functions, and on individual contributors

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in our research and development and operations. From time to time, there may be changes in our executive management team resulting from the hiring or departure of executives, which could disrupt our business. We do not have employment agreements with our executive officers or other key personnel that require them to continue to work for us for any specified period and, therefore, they could terminate their employment with us at any time. The loss of one or more of our executive officers, especially our Chief Executive Officer, or key employees could have an adverse effect on our business.

In addition, to execute our growth plan, we must attract and retain highly qualified personnel. Competition for these personnel in the San Francisco Bay Area, where our headquarters is located, and in other locations where we maintain offices, is intense, especially for engineers experienced in designing and developing software and SaaS applications and experienced sales professionals. We have, from time to time experienced, and we expect to continue to experience, difficulty in hiring and retaining employees with appropriate qualifications. Many of the companies with which we compete for experienced personnel have greater resources than we have. If we hire employees from competitors or other companies, their former employers may attempt to assert that these employees or we have breached their legal obligations, resulting in a diversion of our time and resources. In addition, job candidates and existing employees often consider the value of the equity awards they receive in connection with their employment. If the perceived value of our equity awards declines, it may adversely affect our ability to recruit and retain highly skilled employees. If we fail to attract new personnel or fail to retain and motivate our current personnel, our business and future growth prospects could be adversely affected.

We are highly dependent upon free trials of our customer service platform and live chat software and other inbound lead generation strategies to drive our sales and revenue. If these strategies fail to continue to generate sales opportunities or do not convert into paying customers, our business and results of operations would be harmed.

We are highly dependent upon our marketing strategy of offering free trials of our customer service platform and our live chat software and other inbound lead generation strategies to generate sales opportunities. These strategies may not be successful in continuing to generate sufficient sales opportunities necessary to increase our revenue. Many early users never convert from the trial version to a paid version of our customer service platform or live chat software. Further, we often depend on individuals within an organization who initiate the trial versions of our customer service platform and live chat software being able to convince decision makers within their organization to convert to a paid version. Many of these organizations have complex and multi-layered purchasing requirements. To the extent that these users do not become, or are unable to convince others to become, paying customers, we will not realize the intended benefits of this marketing strategy and our ability to grow our revenue will be adversely affected.

We face a number of risks in our strategy to increasingly target larger organizations for sales of our customer service platform and live chat software and, if we do not manage these efforts effectively, our business and results of operations could be adversely affected.

As we target more of our sales efforts to larger organizations, we expect to incur higher costs and longer sales cycles and we may be less effective at predicting when we will complete these sales. In this market segment, the decision to subscribe to our customer service platform or live chat software may require the approval of more technical personnel and management levels within a potential customer's organization than we have historically encountered, and if so, these types of sales would require us to invest more time educating these potential customers. In addition, larger organizations may demand more features and integration services. We have limited experience in developing and managing sales channels and distribution arrangements for larger organizations. As a result of these

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factors, these sales opportunities may require us to devote greater research and development, sales, product support, and professional services resources to individual customers, resulting in increased costs and reduced profitability, and would likely lengthen our typical sales cycle, which could strain our resources. Additionally, we may be required to increase our investments in our field sales and marketing efforts in order to target these larger organizations, increasing the costs associated with sales. Moreover, these transactions may require us to delay recognizing the associated revenue we derive from these customers until any technical or implementation requirements have been met, and larger customers may demand discounts to the subscription prices they pay for our customer service platform or live chat software. Furthermore, because we have limited experience selling to larger organizations, our investment in marketing our customer service platform to these potential customers may not be successful, which could harm our results of operations and our overall ability to grow our customer base. Following sales to larger organizations, we may have fewer opportunities to expand usage of our customer service platform or sell additional functionality, and we may experience increased subscription terminations as compared to our experience with smaller organizations, any of which could harm our results of operations.

Failure to effectively expand our sales and marketing capabilities could harm our ability to increase our customer base and achieve broader market acceptance of our platform.

Increasing our customer base and achieving broader market acceptance of our customer service platform and live chat software will depend, to a significant extent, on our ability to effectively expand our sales and marketing operations and activities. We are substantially dependent on our online marketing efforts and on our direct sales force to obtain new customers. From December 31, 2013 to December 31, 2014, our sales and marketing organization increased from 165 to 303 employees. We plan to continue to expand our direct sales force both domestically and internationally and to increase the proportion of our sales professionals that have experience in selling to larger organizations. There is significant competition for experienced sales and marketing professionals with the skills and technical knowledge that we require. Our ability to achieve significant revenue growth in the future will depend, in part, on our success in recruiting, training, and retaining a sufficient number of experienced sales and marketing professionals. New hires require significant training and time before they achieve full productivity, particularly in new sales segments and territories. Our recent hires and planned hires may not become as productive as quickly as we expect, and we may be unable to hire or retain sufficient numbers of qualified individuals in the future in the markets where we do business. We cannot predict whether, or to what extent, our sales will increase as we expand our sales and marketing functions or how long it will take for new personnel to become productive. Our business will be harmed if our sales and marketing efforts do not generate a significant increase in revenue.

We employ a pricing model that subjects us to various challenges that could make it difficult for us to derive sufficient value from our customers.

We generally charge our customers for their use of our customer service platform based on the number of users they enable as agents to provide customer service under their customer account. At the same time, we provide features and functionality within our customer service platform that enable our customers to promote customer self-service and otherwise efficiently and cost-effectively address product support requests without the need for substantial human interaction. As a result of these features, customer agent staffing requirements may be minimized and our revenue may be adversely impacted.

We separately charge for the use of our live chat software. Historically, we provided limited chat functionality within our customer service platform for no additional charge. With the integration of our live chat software into our customer service platform, we now generally require a separate subscription to enable chat functionality in connection with our customer service platform. We do not know whether

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our customers or the market in general will accept this change in our pricing model and if it fails to gain acceptance our business and results of operations could be harmed.

Our terms of service prohibit the sharing of user logins and passwords. These restrictions may be improperly circumvented or otherwise bypassed by certain users and, if they are, we may not be able to capture the full value for the use of our customer service platform. We license access and use of our customer service platform and live chat software exclusively for our customers' internal use only. If customers improperly resell or otherwise make our customer service platform or live chat software available to their customers, it may cannibalize our sales or commoditize our customer service platform and live chat software in the market. Additionally, if a customer that has received a volume discount from us offers our customer service platform to its customers in violation of our terms of service, we may experience price erosion and be unable to capture sufficient value from the use of our customer service platform or live chat software by those customers.

While our terms of service provide us the ability to enforce our terms, our customers may resist or refuse to allow us to audit their usage, in which case we may have to pursue legal recourse to enforce our rights. Any such enforcement action would require us to spend money, distract management, and potentially adversely affect our relationship with our customers.

We do not have the history with our subscription or pricing models necessary to accurately predict optimal pricing necessary to attract new customers and retain existing customers.

We have limited experience with respect to determining the optimal prices for our customer service platform and live chat software and as a result, we have in the past and expect in the future that we will need to change our pricing model from time to time. As the market for our customer service platform and live chat software matures, or as new competitors introduce new products or services that compete with ours, we may be unable to attract new customers at the same price or based on the same pricing models as we have used historically. Pricing decisions may also impact the mix of adoption among our subscription plans and negatively impact our overall revenue. Moreover, larger organizations, which are a primary focus of our direct sales efforts, may demand substantial price concessions. As a result, in the future we may be required to reduce our prices, which could adversely affect our revenue, gross margin, profitability, financial position, and cash flow.

Our financial results may fluctuate due to increasing variability in our sales cycles.

We plan our expenses based on certain assumptions about the length and variability of our sales cycle. These assumptions are based upon historical trends for sales cycles and conversion rates associated with our existing customers, many of whom to date have been small to medium-sized organizations that make purchasing decisions with limited interaction with our sales or other personnel. As we continue to focus on and become more dependent on sales to larger organizations, we expect our sales cycles to lengthen and become less predictable. This may adversely affect our financial results. Factors that may influence the length and variability of our sales cycle include:

the need to educate prospective customers about the uses and benefits of our customer service platform and live chat software;

the discretionary nature of purchasing and budget cycles and decisions;

the competitive nature of evaluation and purchasing processes;

evolving functionality demands;

announcements or planned introductions of new products, features, or functionality by us or our competitors;
and

lengthy purchasing approval processes.

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Our increasing dependence on sales to larger organizations may increase the variability of our financial results. If we are unable to close one or more expected significant transactions with these customers in a particular period, or if an expected transaction is delayed until a subsequent period, our operating results for that period, and for any future periods in which revenue from such transaction would otherwise have been recognized, may be adversely affected.

Our quarterly results may fluctuate for various other reasons, and if we fail to meet the expectations of analysts or investors, our stock price and the value of an investment in our common stock could decline substantially.

Our quarterly financial results may fluctuate as a result of a variety of other factors, many of which are outside of our control. If our quarterly financial results fall below the expectations of investors or any securities analysts who follow our stock, the price of our common stock could decline substantially. Some of the important factors that may cause our revenue, operating results, and cash flows to fluctuate from quarter to quarter include:

our ability to attract new customers, retain and increase sales to existing customers, and satisfy our customers requirements;

the number of new employees added;

the rate of expansion and productivity of our sales force;

changes in our or our competitors pricing policies;

the amount and timing of operating costs and capital expenditures related to the operations and expansion of our business;

new products, features, or functionalities introduced by our competitors;

significant security breaches, technical difficulties, or interruptions to our customer service platform or live chat software;

the timing of customer payments and payment defaults by customers;

general economic conditions that may adversely affect either our customers ability or willingness to purchase additional subscriptions, delay a prospective customer s purchasing decision, reduce the value of new subscription contracts, or affect customer retention;

changes in the relative and absolute levels of product support and professional services we provide;

changes in foreign currency exchange rates;

extraordinary expenses such as litigation or other dispute-related settlement payments;

the impact of new accounting pronouncements; and

the timing of the grant or vesting of equity awards to employees.

Many of these factors are outside of our control, and the occurrence of one or more of them might cause our revenue, operating results, and cash flows to vary widely. As such, we believe that quarter-to-quarter comparisons of our revenue, operating results, and cash flows may not be meaningful and should not be relied upon as an indication of future performance.

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Unfavorable conditions in our industry or the global economy or reductions in information technology spending could limit our ability to grow our business and negatively affect our operating results.

Our operating results may vary based on the impact of changes in our industry or the global economy on us or our customers. The revenue growth and potential profitability of our business depend on demand for business software applications and services generally and for customer service systems in particular. In addition, our revenue is entirely dependent on the number of users of our customer service platform or live chat software at each of our customers, which in turn is influenced by the employment and hiring patterns of our customers. To the extent that weak economic conditions cause our customers and prospective customers to freeze or reduce their hiring for personnel providing service and support, demand for our customer service platform and live chat software may be negatively affected. Historically, during economic downturns there have been reductions in spending on information technology and customer service systems as well as pressure for extended billing terms and other financial concessions. If economic conditions deteriorate, our customers and prospective customers may elect to decrease their information technology and customer service budgets, which would limit our ability to grow our business and negatively affect our operating results.

Our business depends substantially on our customers renewing their subscriptions and purchasing additional subscriptions from us. Any decline in our customer retention or expansion would harm our future operating results.

In order for us to maintain or improve our operating results, it is important that our customers renew their subscriptions when the initial contract term expires and add additional authorized agents to their customer accounts. Even though the majority of our revenue is derived from subscriptions to our customer service platform that have terms longer than one month, a significant portion of the subscriptions to our customer service platform have monthly terms. Our customers have no obligation to renew their subscriptions, and our customers may not renew subscriptions with a similar contract period or with the same or a greater number of agents. Some of our customers have elected not to renew their agreements with us and we do not have enough history to accurately predict long-term customer retention.

Our customer retention may decline or fluctuate as a result of a number of factors, including our customers satisfaction with our customer service platform or live chat software, our product support, our prices, the prices of competing software systems, mergers and acquisitions affecting our customer base, the effects of global economic conditions, or reductions in our customers spending levels. Our future success is also substantially dependent on our ability to sell more subscriptions to our current customers. If our customers do not renew their subscriptions, renew on less favorable terms or fail to add more agents, our revenue may decline, and we may not realize improved operating results from our customer base.

If we are unable to develop and maintain successful relationships with channel partners, our business, operating results, and financial condition could be adversely affected.

To date, we have been primarily dependent on word-of-mouth, online marketing, and our direct sales force to sell subscriptions to our customer service platform and live chat software. Although we have developed certain channel partners, such as referral partners, resellers, and integration partners, these channels have resulted in limited revenue to date. We believe that continued growth in our business is dependent upon identifying, developing, and maintaining strategic relationships with additional channel partners that can drive substantial revenue. Our agreements with our existing channel partners are non-exclusive, meaning our channel partners may offer customers the products of several different companies, including products that compete with ours. They may also cease marketing our customer service platform and live chat software with limited or no notice and with little

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or no penalty. We expect that any additional channel partners we identify and develop will be similarly non-exclusive and not bound by any requirement to continue to market our customer service platform or live chat software. If we fail to identify additional channel partners, in a timely and cost-effective manner, or at all, or are unable to assist our current and future channel partners in independently selling and deploying our customer service platform or live chat software, our business, results of operations, and financial condition could be adversely affected. If our channel partners do not effectively market and sell our customer service platform or live chat software, or fail to meet the needs of our customers, our reputation and ability to grow our business may also be adversely affected.

Sales by channel partners are more likely than direct sales to involve collectability concerns, in particular sales by our channel partners into developing markets, and accordingly, variations in the mix between revenue attributable to sales by channel partners and revenue attributable to direct sales may result in fluctuations in our operating results.

If we are not able to maintain and enhance our brand, our business, operating results, and financial condition may be adversely affected.

We believe that maintaining and enhancing our reputation as a differentiated and category-defining company in customer service is critical to our relationships with our existing customers and to our ability to attract new customers. The successful promotion of our brand attributes will depend on a number of factors, including our marketing efforts, our ability to continue to develop high-quality software, and our ability to successfully differentiate our customer service platform from competitive products and services. We are highly dependent upon consumer tactics, including an emphasis on simplicity and a sense of humor in our advertising, to build our brand and develop brand loyalty. We do not have sufficient history to know if such brand promotion activities will ultimately be successful or yield increased revenue relative to traditional enterprise software marketing strategies. In addition, independent industry analysts often provide reviews of our customer service platform, as well as products and services offered by our competitors, and perception of our platform in the marketplace may be significantly influenced by these reviews. If these reviews are negative, or less positive as compared to those of our competitors' products and services, our brand may be adversely affected. It may also be difficult to maintain and enhance our brand in connection with sales through channel or strategic partners.

The promotion of our brand requires us to make substantial expenditures, and we anticipate that the expenditures will increase as our market becomes more competitive, as we expand into new markets, and as more sales are generated through our channel partners. To the extent that these activities yield increased revenue, this revenue may not offset the increased expenses we incur. If we do not successfully maintain and enhance our brand, our business may not grow, we may have reduced pricing power relative to competitors, and we could lose customers or fail to attract potential customers, all of which would adversely affect our business, results of operations, and financial condition.

Our international sales and operations subject us to additional risks that can adversely affect our business, operating results, and financial condition.

In the three months ended December 31, 2013 and 2014, we derived 40% and 45% of our revenue from customers located outside of the United States, respectively, and for each of the fiscal years ended December 31, 2012, 2013, and 2014, we derived 41%, 41%, and 43% of our revenue from customers located outside of the United States, respectively. We are continuing to expand our international operations as part of our growth strategy. We currently have sales personnel and sales and product support operations in the United States and certain countries across Europe, Australia, Asia, and South America. Our sales organization outside the United States is substantially smaller than our sales organization in the United States and to date a very limited portion of our sales has been driven by resellers or other channel partners. We believe our ability to convince new customers to

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subscribe to our platform or to convince existing customers to renew or expand their use of our platform is directly correlated to the level of engagement we obtain with the customer. To the extent we are unable to effectively engage with non-U.S. customers due to our limited sales force capacity and limited channel partners, we may be unable to effectively grow in international markets.

Our international operations subject us to a variety of additional risks and challenges, including:

increased management, travel, infrastructure, and legal compliance costs associated with having multiple international operations;

longer payment cycles and difficulties in enforcing contracts, collecting accounts receivable, or satisfying revenue recognition criteria, especially in emerging markets;

increased financial accounting and reporting burdens and complexities;

requirements or preferences for domestic products;

differing technical standards, existing or future regulatory and certification requirements and required features and functionality;

economic conditions in each country or region and general economic uncertainty around the world;

compliance with foreign privacy and security laws and regulations and the risks and costs of non-compliance;

compliance with laws and regulations for foreign operations, including anti-bribery laws (such as the U.S. Foreign Corrupt Practices Act of 1977, as amended, the U.S. Travel Act, and the U.K. Bribery Act 2010), import and export control laws, tariffs, trade barriers, economic sanctions, and other regulatory or contractual limitations on our ability to sell our customer service platform or live chat software in certain foreign markets, and the risks and costs of non-compliance;

heightened risks of unfair or corrupt business practices in certain geographies and of improper or fraudulent sales arrangements that may impact our financial results and result in restatements of our consolidated financial statements;

fluctuations in currency exchange rates and related effect on our operating results;

difficulties in repatriating or transferring funds from or converting currencies in certain countries;

communication and integration problems related to entering new markets with different languages, cultures, and political systems;

differing labor standards, including restrictions related to, and the increased cost of, terminating employees in some countries;

the need for localized software and licensing programs;

the need for localized language support;

reduced protection for intellectual property rights in some countries and practical difficulties of enforcing rights abroad; and

compliance with the laws of numerous foreign taxing jurisdictions, including withholding obligations, and overlapping of different tax regimes.

Any of these risks could adversely affect our international operations, reduce our international revenue, or increase our operating costs, adversely affecting our business, operating results, financial condition, and growth prospects.

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Compliance with laws and regulations applicable to our international operations substantially increases our cost of doing business in foreign jurisdictions. We may be unable to keep current with changes in government requirements as they change from time to time. Failure to comply with these regulations could have adverse effects on our business. In many foreign countries it is common for others to engage in business practices that are prohibited by our internal policies and procedures or U.S. or other regulations applicable to us. Although we have implemented policies and procedures designed to ensure compliance with these laws and policies, there can be no assurance that all of our employees, contractors, partners, and agents will comply with these laws and policies. Violations of laws or key control policies by our employees, contractors, partners, or agents could result in delays in revenue recognition, financial reporting misstatements, enforcement actions, disgorgement of profits, fines, civil and criminal penalties, damages, injunctions, other collateral consequences, or the prohibition of the importation or exportation of our platform and services and could adversely affect our business and results of operations.

We are subject to governmental export and import controls that could impair our ability to compete in international markets or subject us to liability if we violate the controls.

We are subject to U.S. export controls, and we incorporate encryption technology into our customer service platform and live chat software that is enabled through mobile applications and other software we may be deemed to export. These encryption products and the underlying technology may be exported outside of the United States only with the required export authorizations, including by license, a license exception or other appropriate government authorizations, including the filing of an encryption registration. We previously deployed mobile applications prior to obtaining the required export authorizations. Accordingly, we have not fully complied with applicable encryption controls in U.S. Export Administration Regulations. As discussed further below, in 2013, we filed final voluntary disclosures to relevant U.S. enforcement authorities regarding our failure to obtain required export authorizations.

Furthermore, U.S. export control laws and economic sanctions prohibit the shipment of certain products and services to countries, territories, governments, and persons targeted by U.S. sanctions. While we are currently taking precautions to prevent our customer service platform and live chat software from being enabled by persons targeted by U.S. sanctions, including IP blocking and periodic customer screening against U.S. government lists of prohibited persons, such measures may be circumvented. Given the technical limitations in developing measures that will prevent access to internet based services from particular geographies or by particular individuals, we have previously identified and expect we will continue to identify customer accounts for our customer service platform and live chat software that we suspect originate from countries which are subject to U.S. embargoes.

We are aware that trials of and subscriptions to our customer service platform have been initiated by persons and organizations in countries that are the subject of U.S. embargoes. Our provision of service in these instances was likely in violation of U.S. export control and sanctions laws. We have terminated the accounts of such organizations as we have become aware of them, and in April 2013, we filed final voluntary self-disclosures with the U.S. Department of Commerce's Bureau of Industry and Security, or BIS, and the U.S. Department of Treasury's Office of Foreign Assets Control, or OFAC, concerning prior potential violations. In May 2013, OFAC notified us that it had completed its review of these matters and closed its review with the issuance of a cautionary letter. In July 2013, BIS notified us that it had completed its review with the issuance of a warning letter. No monetary penalties or other sanctions were imposed by either agency in connection with their investigations.

We are also aware that trials of, and paid and unpaid subscriptions to, our live chat software as delivered by Zopim, which is based in Singapore, have been initiated by persons and organizations in countries that are the subject of U.S. embargoes. Zopim also previously made available for download

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from the United States certain encryption-functionality software without first having obtained U.S. government authorization to export such software. In these instances, Zopim may have acted in violation of U.S. export controls and sanctions laws. Prior to and as a condition of the completion of our acquisition of Zopim, Zopim terminated the paid subscriptions of those customers believed to be located in jurisdictions subject to U.S. embargoes, screened its paid customers against applicable U.S. government lists of prohibited persons, implemented certain measures designed to prevent future unauthorized access to the service, and obtained U.S. government authorization to export its software. Zopim filed initial voluntary disclosures with OFAC and BIS in March 2014 to alert these agencies of its apparent prior violations. After completion of the acquisition, we conducted an internal investigation into these prior violations and filed voluntary self-disclosures with respect to these matters in June 2014 and September 2014. In January 2015, BIS notified us that it had completed its review of the potential violations of U.S. export controls laws by Zopim with the issuance of a warning letter. No monetary penalties or other sanctions were imposed by BIS in connection with its investigation. OFAC's review of Zopim's voluntary self-disclosure is ongoing.

If we are found to be in violation of U.S. sanctions or export control laws, it could result in fines or penalties for us and for individuals, including civil penalties of up to \$250,000 or twice the value of the transaction, whichever is greater, per violation, and in the event of conviction for a criminal violation, fines of up to \$1 million and possible incarceration for responsible employees and managers for willful and knowing violations. Each instance in which we provide service through our customer service platform or live chat software or in which unlicensed encryption functionality software is downloaded may constitute a separate violation of these laws.

If our channel partners fail to obtain appropriate import, export or re-export licenses or permits, we may also be adversely affected, through reputational harm as well as other negative consequences including government investigations and penalties. We presently incorporate sanctions compliance requirements in our channel partner agreements for our customer service platform and live chat software. Complying with export control and sanctions regulations for a particular sale may be time-consuming and may result in the delay or loss of sales opportunities. Failure to comply with export control and sanctions regulations for a particular sale may expose us to government investigations and penalties, which could have an adverse effect on our business, operating results, and financial condition.

In addition, various countries regulate the import of certain encryption technology, including import permitting and licensing requirements, and have enacted laws that could limit our ability to offer our platform or distribute our platform or could limit our customers' ability to implement our platform in those countries. Changes in our customer service platform or live chat software or future changes in export and import regulations may create delays in the introduction of our customer service platform or live chat software in international markets or prevent our customers with international operations from deploying our platform globally. Any change in export or import regulations, economic sanctions or related legislation, or change in the countries, governments, persons, or technologies targeted by such regulations, could result in decreased use of our customer service platform or live chat software by, or in our decreased ability to export or sell our customer service platform or live chat software to, existing or potential customers with international operations. Any decreased use of our customer service platform or live chat software or limitation on our ability to export or sell our customer service platform or live chat software would likely adversely affect our business operations and financial results.

We recognize revenue over the term of our customer contracts. Consequently, downturns or upturns in new sales may not be immediately reflected in our operating results and may be difficult to discern.

We generally recognize subscription revenue from customers ratably over the terms of their contracts and a majority of our revenue is derived from subscriptions that have terms longer than one

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month. As a result, a portion of the revenue we report in each quarter is derived from the recognition of deferred revenue relating to subscriptions entered into during previous quarters. Consequently, a decline in new or renewed subscriptions with terms that are longer than monthly in any single quarter may have a small impact on our revenue results for that quarter. However, such a decline will negatively affect our revenue in future quarters. Accordingly, the effect of significant downturns in sales and market acceptance of our customer service platform or live chat software, and potential changes in our pricing policies or rate of expansion or retention, may not be fully reflected in our results of operations until future periods. We may also be unable to reduce our cost structure in line with a significant deterioration in sales. In addition, because we believe a substantial percentage of subscriptions to our customer service platform and live chat software are shorter than most comparable SaaS companies and because we have many variations of billing cycles, our deferred revenue may be a less meaningful indicator of our future financial results than for other SaaS companies. In addition, a significant majority of our costs are expensed as incurred, while revenue is recognized over the life of the agreement with our customer. As a result, increased growth in the number of our customers could continue to result in our recognition of more costs than revenue in the earlier periods of the terms of our agreements. Our subscription model also makes it difficult for us to rapidly increase our revenue through additional sales in any period, as revenue from new customers must be recognized over the applicable subscription term.

Certain of our operating results and financial metrics may be difficult to predict as a result of seasonality.

Although we have not historically experienced significant seasonality in terms of the number of subscriptions for our customer service platform throughout the year, we may be impacted by seasonal trends in the future, particularly as our business matures. We do not have sufficient experience in selling our live chat software to determine if demand for this service is or will be subject to material seasonality. Since a large percentage of our subscriptions are monthly, customers are able to rapidly increase and decrease the number of authorized agents for whom they require a subscription quickly and easily, thereby potentially increasing the impact of seasonality on our revenue. This seasonality may be reflected to a much lesser extent, and sometimes may not be immediately apparent, in our revenue, due to the fact that we recognize subscription revenue over the term of our agreement. To the extent we experience this seasonality, it may cause fluctuations in our operating results and financial metrics, and make forecasting our future operating results and financial metrics difficult.

Our ongoing and planned investments in self-managed colocation data centers are expensive and complex, have resulted, and will result, in a negative impact on our cash flows and may negatively impact our financial results.

We have made and will continue to make substantial investments in new equipment for use in our self-managed colocation data centers to support our growth and provide enhanced levels of service to our customers. We made capital expenditures relating to hosting equipment for use in these data centers of \$0.8 million and \$0.2 million in the three months ended December 31, 2013 and 2014, respectively, and \$1.5 million, \$5.5 million, and \$6.2 million in the years ended December 31, 2012, 2013, and 2014, respectively. We have and are continuing to transition from primarily a managed-service hosting model, where a third party manages most aspects of our hosting operations, to a self-managed colocation model, where we have more direct control over the hosting infrastructure and its operation. This has and may continue to have a negative impact on our cash flows and gross profit as we invest in capital assets to establish and expand our use of these self-managed colocation data centers and scale these facilities to expected demand. If it takes longer than we expect to fully complete this transition, the negative impact on our operating results would likely exceed our initial expectations.

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Our business and growth depend in part on the success of our strategic relationships with third parties, including technology partners, channel partners, and professional services partners.

We depend on, and anticipate that we will continue to depend on, various third-party relationships in order to sustain and grow our business. We are highly dependent upon third-party technology partners for certain critical features and functionality of our platform. For example, the advanced analytics features of the higher end subscription plans of our customer service platform are highly dependent on our technology integration with GoodData, Inc. Failure of this or any other technology provider to maintain, support, or secure its technology platforms in general, and our integrations in particular, or errors or defects in its technology, could materially and adversely impact our relationship with our customers, damage our reputation and brand, and harm our business and operating results. Any loss of the right to use any of this hardware or software could result in delays or difficulties in our ability to provide our platform until equivalent technology is either developed by us or, if available, identified, obtained, and integrated.

For deployments of our customer service platform into complex technology environments and workflows, we are highly dependent on third-party implementation consultants to provide professional services to our customers. The failure of these third-party consultants to perform their services adequately may disrupt or damage the relationship between us and our customer, damage our brand, and harm our business.

Identifying, negotiating, and documenting relationships with strategic third parties such as technology partners and implementation providers require significant time and resources. In addition, integrating third-party technology is complex, costly, and time-consuming. Our agreements with technology partners and implementation providers are typically limited in duration, non-exclusive, and do not prohibit them from working with our competitors or from offering competing services. Our competitors may be effective in providing incentives to third parties to favor their products or services or to prevent or reduce subscriptions to our platform.

If we are unsuccessful in establishing or maintaining our relationships with these strategic third parties, our ability to compete in the marketplace or to grow our revenue could be impaired and our operating results would suffer. Even if we are successful, we cannot assure you that these relationships will result in improved operating results.

If we fail to integrate our customer service platform and live chat software with a variety of operating systems, software applications, and hardware that are developed by others, our customer service platform and live chat software may become less marketable, less competitive, or obsolete, and our operating results would be harmed.

Our customer service platform and live chat software must integrate with a variety of network, hardware, and software platforms, and we need to continuously modify and enhance our customer service platform and live chat software to adapt to changes in cloud-enabled hardware, software, networking, browser, and database technologies. In particular, we have developed our platform to be able to easily integrate with third-party SaaS applications, including the applications of software providers that compete with us, through the interaction of APIs. In general, we rely on the fact that the providers of such software systems, including salesforce.com, continue to allow us access to their APIs to enable these customer integrations. To date, we have not relied on a long-term written contract to govern our relationship with these providers. Instead, we are subject to the standard terms and conditions for application developers of such providers, which govern the distribution, operation, and fees of such software systems, and which are subject to change by such providers from time to time. Our business may be harmed if any provider of such software systems:

discontinues or limits our access to its APIs;

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modifies its terms of service or other policies, including fees charged to, or other restrictions on us or other application developers;

changes how customer information is accessed by us or our customers;

establishes more favorable relationships with one or more of our competitors; or

otherwise favors its own competitive offerings over ours.

We believe a significant component of our value proposition to customers is the ability to optimize and configure our customer service platform to communicate with these third-party SaaS applications through our respective APIs. If we are not permitted or able to integrate with these and other third-party SaaS applications in the future, demand for our customer service platform could be adversely impacted and business and operating results would be harmed. In addition, an increasing number of individuals within organizations are utilizing mobile devices to access the Internet and corporate resources and to conduct business. We have designed mobile applications to provide access to our customer service platform through these devices. If we cannot provide effective functionality through these mobile applications as required by organizations and individuals that widely use mobile devices, we may experience difficulty attracting and retaining customers. Failure of our customer service platform or live chat software to operate effectively with future infrastructure platforms and technologies could also reduce the demand for our platform, resulting in customer dissatisfaction and harm to our business. If we are unable to respond to changes in a cost-effective manner, our platform may become less marketable, less competitive, or obsolete and our operating results may be negatively impacted.

We may acquire or invest in companies, which may divert our management's attention and result in additional dilution to our stockholders. We may be unable to integrate acquired businesses and technologies successfully or achieve the expected benefits of such acquisitions.

We may evaluate and consider potential strategic transactions, including acquisitions of, or investments in, businesses, technologies, services, products, and other assets in the future. We also may enter into relationships with other businesses to expand our products and services, which could involve preferred or exclusive licenses, additional channels of distribution, discount pricing, or investments in other companies.

Any acquisition, including our acquisition of Zopim, investment or business relationship may result in unforeseen operating difficulties and expenditures. In particular, we may encounter difficulties assimilating or integrating the businesses, technologies, products, personnel, or operations of the acquired companies, particularly if the key personnel of the acquired company choose not to work for us, their software is not easily adapted to work with our platform, or we have difficulty retaining the customers of any acquired business due to changes in ownership, management, or otherwise. For example, we only recently completed our acquisition of Zopim, and substantially all of the acquisition and integration risks remain. Acquisitions, including our acquisition of Zopim, may also disrupt our business, divert our resources, and require significant management attention that would otherwise be available for development of our existing business. Moreover, the anticipated benefits of any acquisition, investment, or business relationship may not be realized or we may be exposed to unknown risks or liabilities.

Negotiating these transactions can be time-consuming, difficult, and expensive, and our ability to complete these transactions may often be subject to approvals that are beyond our control. Consequently, these transactions, even if announced, may not be completed. For one or more of those transactions, we may:

issue additional equity securities that would dilute our existing stockholders;

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use cash that we may need in the future to operate our business;

incur large charges or substantial liabilities;

incur debt on terms unfavorable to us or that we are unable to repay;

encounter difficulties retaining key employees of the acquired company or integrating diverse software codes or business cultures; and

become subject to adverse tax consequences, substantial depreciation, or deferred compensation charges.

Because our customer service platform and live chat software can be used to collect and store personal information, domestic and international privacy and data security concerns could result in additional costs and liabilities to us or inhibit sales of our customer service platform or live chat software.

Personal privacy and data security have become significant issues in the United States, Europe, and in many other jurisdictions where we offer our customer service platform or live chat software. The regulatory framework for privacy and security issues worldwide is rapidly evolving and is likely to remain uncertain for the foreseeable future. Many federal, state, and foreign government bodies and agencies have adopted, or are considering adopting, laws and regulations regarding the collection, use, and disclosure of personal information. In the United States, these include rules and regulations promulgated under the authority of federal agencies and state attorneys general and consumer protection agencies. Internationally, virtually every jurisdiction in which we operate has established its own data security and privacy legal framework with which we or our customers must comply, including Directive 95/46/EC on the protection of individuals with regard to the processing of personal data and on the free movement of such data established in the European Union, or the Data Protection Directive, and data protection legislation of the individual member states subject to the Data Protection Directive. The Data Protection Directive will likely be replaced in time with the pending European General Data Protection Regulation which may impose additional obligations and risk upon our business. In many jurisdictions enforcement actions and consequences for non-compliance are also rising.

We certify adherence to the U.S. Department of Commerce's Safe Harbor Privacy Principles and comply with the U.S.-EU and U.S.-Swiss Safe Harbor Frameworks with respect to our customer service platform, however, it is not clear whether or for how long applicable data protection authorities in the European Union will continue to recognize such certification as a valid method of compliance with restrictions set forth in the Data Protection Directive and data protection legislation of individual member states restricting the transfer of data outside of the European Economic Area. Since our live chat software is provided by Zopim, a company organized under the laws of Singapore, certification to the U.S. Department of Commerce's Safe Harbor Privacy Principles and compliance with the U.S.-EU and U.S.-Swiss Safe Harbor Frameworks with respect to our live chat software is not available (to the extent such safe harbor processes are still recognized). The inability to certify such compliance means that the EU Privacy Directive and other privacy regimes may impose additional obligations to obtain consent from data subjects to transfer personally identifiable information, or PII, outside of the European Union on the part of our EU-based customers that use our live chat software. Additionally, the inability to certify such compliance or otherwise provide acceptable privacy assurances may inhibit the sale and use of our live chat software in the European Union and certain other markets, which could, were it to occur, harm our business and operating results.

In addition to government regulation, privacy advocates and industry groups may propose new and different self-regulatory standards that either legally or contractually apply to us. Further, our customers may require us to comply with more stringent privacy and data security contractual requirements.

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Because the interpretation and application of many privacy and data protection laws and commercial frameworks and standards are uncertain, it is possible that these laws, frameworks, and standards may be interpreted and applied in a manner that is inconsistent with our existing data management practices or the features of our customer service platform or live chat software. If so, in addition to the possibility of fines, lawsuits, breach of contract claims, and other claims and penalties, we could be required to fundamentally change our business activities and practices or modify our customer service platform or live chat software, which could have an adverse effect on our business. Any inability to adequately address privacy and security concerns, even if unfounded, or comply with applicable privacy and security or data security laws, regulations and policies, could result in additional cost and liability to us, damage our reputation, inhibit sales, and adversely affect our business.

Furthermore, the costs of compliance with, and other burdens imposed by, the laws, regulations, and policies that are applicable to the businesses of our customers may limit the use and adoption of, and reduce the overall demand for, our customer service platform or live chat software. Privacy and data security concerns, whether valid or not valid, may inhibit market adoption of our customer service platform or live chat software, particularly in certain industries and foreign countries.

We may be sued by third parties for alleged infringement of their proprietary rights.

There is considerable patent and other intellectual property development activity in our industry. Our future success depends in part on not infringing upon the intellectual property rights of others. From time to time, our competitors or other third parties may claim that we are infringing upon their intellectual property rights, and we may be found to be infringing upon such rights. We may receive claims from third parties, including our competitors, that our customer service platform or live chat software and underlying technology infringe or violate a third party's intellectual property rights, and we may be found to be infringing upon such rights. We may be unaware of the intellectual property rights of others that may cover some or all of our technology. Any claims or litigation could cause us to incur significant expenses and, if successfully asserted against us, could require that we pay substantial damages or ongoing royalty payments, prevent us from offering our customer service platform or live chat software, or require that we comply with other unfavorable terms. We may also be obligated to indemnify our customers or business partners in connection with any such litigation and to obtain licenses, modify our customer service platform or live chat software, or refund subscription fees, which could further exhaust our resources. In addition, we may incur substantial costs to resolve claims or litigation, whether or not successfully asserted against us, which could include payment of significant settlement, royalty or license fees, modification of our customer service platform or live chat software, or refunds to customers of subscription fees. Even if we were to prevail in the event of claims or litigation against us, any claim or litigation regarding our intellectual property could be costly and time-consuming and divert the attention of our management and other employees from our business operations. Such disputes could also disrupt our customer service platform or live chat software, adversely impacting our customer satisfaction and ability to attract customers.

Indemnity provisions in various agreements potentially expose us to substantial liability for intellectual property infringement and other losses.

Our agreements with customers and other third parties may include indemnification or other provisions under which we agree to indemnify or otherwise be liable to them for losses suffered or incurred as a result of claims of intellectual property infringement, damages caused by us to property or persons, or other liabilities relating to or arising from our customer service platform or live chat software or other acts or omissions. The term of these contractual provisions often survives termination or expiration of the applicable agreement. Large indemnity payments or damage claims from contractual breach could harm our business, operating results, and financial condition. From time to time, customers require us to indemnify or otherwise be liable to them for breach of confidentiality or

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failure to implement adequate security measures with respect to their data stored, transmitted, or processed by our customer service platform or live chat software. Although we normally contractually limit our liability with respect to such obligations, we may still incur substantial liability related to them. Any dispute with a customer with respect to such obligations could have adverse effects on our relationship with that customer and other current and prospective customers, reduce demand for our customer service platform, and harm our business and operating results.

Our use of open source software could negatively affect our ability to sell our customer service platform and live chat software and subject us to possible litigation.

We use open source software in our customer service platform and live chat software and expect to continue to use open source software in the future. We may face claims from others claiming ownership of, or seeking to enforce the terms of, an open source license, including by demanding release of the open source software, derivative works or our proprietary source code that was developed using such software. These claims could also result in litigation, require us to purchase a costly license or require us to devote additional research and development resources to change our customer service platform or live chat software, any of which would have a negative effect on our business and operating results. In addition, if the license terms for the open source software we utilize change, we may be forced to reengineer our customer service platform or live chat software or incur additional costs. Although we have implemented policies to regulate the use and incorporation of open source software into our customer service platform and live chat software, we cannot be certain that we have not incorporated open source software in our customer service platform or live chat software in a manner that is inconsistent with such policies.

Any failure to protect our intellectual property rights could impair our ability to protect our proprietary technology and our brand.

Our success and ability to compete depend in part upon our intellectual property. We currently have one issued patent and have a limited number of patent applications, none of which may result in an issued patent. We primarily rely on copyright, trade secret and trademark laws, trade secret protection, and confidentiality or license agreements with our employees, customers, partners, and others to protect our intellectual property rights. However, the steps we take to protect our intellectual property rights may be inadequate.

In order to protect our intellectual property rights, we may be required to spend significant resources to monitor and protect these rights. Litigation brought to protect and enforce our intellectual property rights could be costly, time-consuming, and distracting to management, and could result in the impairment or loss of portions of our intellectual property. Furthermore, our efforts to enforce our intellectual property rights may be met with defenses, counterclaims, and countersuits attacking the validity and enforceability of our intellectual property rights. Our failure to secure, protect, and enforce our intellectual property rights could adversely affect our brand and adversely impact our business.

We may not be able to secure additional financing on favorable terms, or at all, to meet our future capital needs.

We have funded our operations since inception primarily through sales of equity securities, capital lease arrangements, loans for equipment, and subscription payments by our customers for use of our customer service platform and live chat software. We do not know when or if our operations will generate sufficient cash to fund our ongoing operations. In the future, we may require additional capital to respond to business opportunities, challenges, acquisitions, a decline in the level of subscriptions for our customer service platform, or unforeseen circumstances. We may not be able to timely secure additional debt or equity financing on favorable terms, or at all. Any debt financing obtained by us could

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involve restrictive covenants relating to financial and operational matters, which may make it more difficult for us to obtain additional capital and to pursue business opportunities, including potential acquisitions. If we raise additional funds through further issuances of equity, convertible debt securities or other securities convertible into equity, our existing stockholders could suffer significant dilution in their percentage ownership of our company, and any new equity securities we issue could have rights, preferences and privileges senior to those of holders of our common stock. If we are unable to obtain adequate financing or financing on terms satisfactory to us, when we require it, our ability to continue to grow or support our business and to respond to business challenges could be significantly limited.

We face exposure to foreign currency exchange rate fluctuations.

As our international operations expand, our exposure to the effects of fluctuations in currency exchange rates grows. While we have primarily transacted with customers and vendors in U.S. dollars historically, we expect to continue to expand the number of transactions with our customers that are denominated in foreign currencies in the future. Fluctuations in the value of the U.S. dollar and foreign currencies may make our subscriptions more expensive for international customers, which could harm our business. Additionally, we incur expenses for employee compensation and other operating expenses at our non-U.S. locations in the local currency for such locations. Fluctuations in the exchange rates between the U.S. dollar and other currencies could result in an increase to the U.S. dollar equivalent of such expenses. These fluctuations could cause our results of operations to differ from our expectations or the expectations of our investors. Additionally, such foreign currency exchange rate fluctuations could make it more difficult to detect underlying trends in our business and results of operations.

Our international subsidiaries maintain net assets that are denominated in currencies other than the functional operating currencies of these entities. Accordingly, changes in the value of foreign currencies relative to the U.S. dollar can affect our operating results due to transactional and translational remeasurements that are reflected in our results of operations. To the extent that fluctuations in currency exchange rates cause our results of operations to differ from our expectations or the expectations of our investors, the trading price of our common stock could be adversely affected.

We do not currently maintain a program to hedge transactional exposures in foreign currencies. However, in the future, we may use derivative instruments, such as foreign currency forward and option contracts, to hedge certain exposures to fluctuations in foreign currency exchange rates. The use of such hedging activities may not offset any or more than a portion of the adverse financial effects of unfavorable movements in foreign exchange rates over the limited time the hedges are in place. Moreover, the use of hedging instruments may introduce additional risks if we are unable to structure effective hedges with such instruments.

Taxing authorities may successfully assert that we should have collected or in the future should collect sales and use, value added or similar taxes, and we could be subject to liability with respect to past or future sales, which could adversely affect our results of operations.

We do not collect sales and use, value added and similar taxes in all jurisdictions in which we have sales, based on our understanding that such taxes are not applicable. Sales and use, value added, and similar tax laws and rates vary greatly by jurisdiction. Certain jurisdictions in which we do not collect such taxes may assert that such taxes are applicable, which could result in tax assessments, penalties, and interest, and we may be required to collect such taxes in the future. Such tax assessments, penalties, and interest, or future requirements may adversely affect our results of operations.

Table of Contents***Our international operations subject us to potentially adverse tax consequences.***

We generally conduct our international operations through subsidiaries and report our taxable income in various jurisdictions worldwide based upon our business operations in those jurisdictions. Our intercompany relationships are subject to complex transfer pricing regulations administered by taxing authorities in various jurisdictions. The relevant taxing authorities may disagree with our determinations as to the value of assets sold or acquired or income and expenses attributable to specific jurisdictions. If such a disagreement were to occur, and our position were not sustained, we could be required to pay additional taxes, interest and penalties, which could result in one-time tax charges, higher effective tax rates, reduced cash flows, and lower overall profitability of our operations. We believe that our financial statements reflect adequate reserves to cover such a contingency, but there can be no assurances in that regard.

If our goodwill or intangible assets become impaired, we may be required to record a significant charge to earnings.

We review our intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is required to be tested for impairment at least annually. As of December 31, 2014, we had a total of \$14.2 million of goodwill and intangible assets related to our acquisition of Zopim. An adverse change in market conditions, particularly if such change has the effect of changing one of our critical assumptions or estimates, could result in a change to the estimation of fair value that could result in an impairment charge to our goodwill or intangible assets. Any such charges may have a material negative impact on our operating results.

Our ability to use our net operating losses to offset future taxable income may be subject to certain limitations.

As of December 31, 2014, we had federal and state net operating loss carryforwards, or NOLs, of \$133.0 million and \$47.5 million, respectively, due to prior period losses. In general, under Section 382 of the Internal Revenue Code of 1986, as amended, or the Code, a corporation that undergoes an ownership change can be subject to limitations on its ability to utilize its NOLs to offset future taxable income. Our existing NOLs may be subject to limitations arising from previous ownership changes, including in connection with our IPO. Future changes in our stock ownership, some of which are outside of our control, could result in an ownership change under Section 382 of the Code. Furthermore, our ability to utilize NOLs of companies that we may acquire in the future may be subject to limitations. There is also a risk that due to regulatory changes, such as suspensions on the use of NOLs, or other unforeseen reasons, our existing NOLs could expire or otherwise be unavailable to offset future income tax liabilities. For these reasons, we may not be able to realize a tax benefit from the use of our NOLs, whether or not we attain profitability.

Our estimates of market opportunity and forecasts of market growth included in this prospectus may prove to be inaccurate, and even if the market in which we compete achieves the forecasted growth, our business could fail to grow at similar rates, if at all.

Market opportunity estimates and growth forecasts are subject to significant uncertainty and are based on assumptions and estimates that may not prove to be accurate. Our estimates and forecasts relating to the size and expected growth of the customer relationship management market may prove to be inaccurate. Even if the market in which we compete meets our size estimates and forecasted growth, our business could fail to grow at similar rates, if at all.

We may not be able to generate sufficient cash to service our indebtedness.

As of December 31, 2014, we owed an aggregate principal and accrued interest amount of \$7.0 million pursuant to a credit facility. Our ability to make scheduled payments or to refinance our

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debt obligations depends on numerous factors, including the amount of our cash balances and our actual and projected financial and operating performance. We may be unable to maintain a level of cash balances or cash flows sufficient to permit us to pay the principal, premium, if any, and interest on our existing or future indebtedness. If our cash flows and capital resources are insufficient to fund our debt service obligations, we may be forced to reduce or delay capital expenditures, sell assets or operations, seek additional capital, or restructure or refinance our indebtedness. We may not be able to take any of these actions, and even if we are, these actions may be insufficient to permit us to meet our scheduled debt service obligations. In addition, in the event of our breach of the credit facility, we may be required to repay any outstanding amounts earlier than anticipated.

Our credit facility contains restrictive and financial covenants that may limit our operating flexibility.

Our credit facility contains certain restrictive covenants that either limit our ability to, or require a mandatory prepayment in the event we, incur additional indebtedness and liens, merge with other companies or consummate certain changes of control, acquire other companies, engage in new lines of business, make certain investments, pay dividends, transfer or dispose of assets, amend certain material agreements, and enter into various specified transactions. We, therefore, may not be able to engage in any of the foregoing transactions unless we obtain the consent of our lender or prepay the outstanding amount under the credit facility. The credit facility also contains certain financial covenants, including minimum revenue and cash balance requirements, and financial reporting requirements. Our obligations under the credit facility are secured by all of our property, with limited exceptions. We may not be able to generate sufficient cash flow or sales to meet the financial covenants or pay the principal and interest under the credit facility. Furthermore, our future working capital, borrowings, or equity financing could be unavailable to repay or refinance the amounts outstanding under the credit facility. In the event of a liquidation, our lender would be repaid all outstanding principal and interest prior to distribution of assets to unsecured creditors, and the holders of our common stock would receive a portion of any liquidation proceeds only if all of our creditors, including our lender, were first repaid in full.

We depend and rely upon SaaS technologies from third parties to operate our business and interruptions or performance problems with these technologies may adversely affect our business and operating results.

We rely heavily on hosted SaaS applications from third parties in order to operate critical functions of our business, including billing and order management, enterprise resource planning, and financial accounting services. If these services become unavailable due to extended outages, interruptions, or because they are no longer available on commercially reasonable terms, our expenses could increase, our ability to manage finances could be interrupted and our processes for managing sales of our platform and supporting our customers could be impaired until equivalent services, if available, are identified, obtained, and implemented, all of which could adversely affect our business.

Changes in laws and regulations related to the Internet or changes in the Internet infrastructure itself may diminish the demand for our platform, cause us to incur additional expenses or otherwise have a negative impact on our business.

The future success of our business depends upon the continued use of the Internet as a primary medium for commerce, communication, and business applications. Federal, state, or foreign government bodies or agencies have in the past adopted, and may in the future adopt, laws or regulations affecting the use of the Internet as a commercial medium. Changes in these laws or regulations could require us to modify our platform in order to comply with these changes or

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substantially increase costs associated with the operation of our customer service platform and live chat software. Additionally, the adoption of any laws, regulations, or practices limiting Internet neutrality, could allow Internet service providers to block, degrade or interfere with our products or services. These laws, regulations, or practices could decrease the demand for, or the usage of, our products and services, increase our cost of doing business and adversely affect our operating results. In addition, government agencies or private organizations have imposed and may impose additional taxes, fees, or other charges for accessing the Internet or commerce conducted via the Internet. These laws or charges could limit the growth of Internet-related commerce or communications generally, or result in reductions in the demand for Internet-based platforms and services such as ours. In addition, the use of the Internet as a business tool could be adversely affected due to delays in the development or adoption of new standards and protocols to handle increased demands of Internet activity, security, reliability, cost, ease-of-use, accessibility, and quality of service. The performance of the Internet and its acceptance as a business tool has been adversely affected by viruses, worms, and similar malicious programs and the Internet has experienced a variety of outages and other delays as a result of damage to portions of its infrastructure.

Catastrophic events may disrupt our business.

Our corporate headquarters are located in San Francisco, California and we operate in or utilize data centers that are located in North America, Europe, and Asia. Key features and functionality of our customer service platform are enabled by third parties that are headquartered in California and operate in or utilize data centers in the United States and Europe. Additionally, we rely on our network and third-party infrastructure and enterprise applications, internal technology systems, and our website for our development, marketing, operational support, hosted services, and sales activities. In the event of a major earthquake, hurricane, or catastrophic event such as fire, power loss, telecommunications failure, cyber-attack, war, or terrorist attack, we may be unable to continue our operations and may endure system interruptions, reputational harm, delays in our application development, lengthy interruptions in our platform, breaches of data security, and loss of critical data, all of which could have an adverse effect on our future operating results.

Risks Related to Ownership of Our Common Stock and this Offering

Our stock price has been, and may continue to be, volatile or may decline regardless of our operating performance resulting in substantial losses for investors purchasing shares in this offering.

The trading price of our common stock has been, and may continue to be, volatile and could fluctuate widely regardless of our operating performance. The market price of our common stock may fluctuate significantly in response to numerous factors, many of which are beyond our control, including:

actual or anticipated fluctuations in our operating results;

the financial projections we may provide to the public, any changes in these projections or our failure to meet these projections;

failure of securities analysts to initiate or maintain coverage of our company, changes in financial estimates and publication of other news by any securities analysts who follow our company, or our failure to meet these estimates or the expectations of investors;

ratings changes by any securities analysts who follow our company;

announcements by us or our competitors of significant technical innovations, acquisitions, strategic partnerships, joint ventures, or capital commitments;

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changes in operating performance and stock market valuations of other technology companies generally, or those in our industry in particular;

price and volume fluctuations in the overall stock market from time to time, including as a result of trends in the economy as a whole;

changes in accounting standards, policies, guidelines, interpretations, or principles;

actual or anticipated developments in our business or our competitors' businesses or the competitive landscape generally;

developments or disputes concerning our intellectual property or our products, or third-party proprietary rights;

announced or completed acquisitions of businesses or technologies by us or our competitors;

new laws or regulations or new interpretations of existing laws, or regulations applicable to our business;

any major change in our board of directors or management;

sales of shares of our common stock by us or our stockholders;

lawsuits threatened or filed against us; and

other events or factors, including those resulting from war, incidents of terrorism, or responses to these events. In addition, the stock markets have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many technology companies. Stock prices of many technology companies have fluctuated in a manner unrelated or disproportionate to the operating performance of those companies. In the past, stockholders have instituted securities class action litigation following periods of market volatility. If we were to become involved in securities litigation, it could subject us to substantial costs, divert resources and the attention of management from operating our business, and adversely affect our business, results of operations, financial condition, and cash flows.

Our directors, officers, and principal stockholders beneficially own a significant percentage of our stock and will be able to exert significant control over matters subject to stockholder approval.

As of February 28, 2015, our directors, officers, five percent or greater stockholders, and their respective affiliates beneficially owned in the aggregate approximately 53.3% of our outstanding voting stock and, upon the completion of

this offering, that same group will beneficially own in the aggregate approximately 47.6% of our outstanding voting stock (assuming no exercise of the underwriters' option to purchase additional shares). As a result, these stockholders have the ability to influence us through this ownership position. These stockholders may be able to determine all matters requiring stockholder approval. For example, these stockholders may be able to control elections of directors, amendments of our organizational documents, and approval of any merger, sale of assets, or other major corporate transaction. This may prevent or discourage unsolicited acquisition proposals or offers for our common stock that you may feel are in your best interest as one of our stockholders.

Substantial future sales of shares of our common stock could cause the market price of our common stock to decline.

The market price of our common stock could decline as a result of substantial sales of our common stock, particularly sales by our directors, executive officers and significant stockholders, or the

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perception in the market that holders of a large number of shares intend to sell their shares. After this offering, we will have outstanding 83,097,076 shares of our common stock, based on the number of shares outstanding as of December 31, 2014 and after giving effect to the issuance of 20,000 shares of common stock to be acquired by a certain selling stockholder upon the exercise of options in order to sell those shares in this offering. This includes the 8,530,000 shares included in this offering and all 12,777,777 shares of our common stock sold by us in our IPO, which may be resold in the public market immediately, subject in some cases to volume and other restrictions of Rule 144 under the Securities Act of 1933, as amended, or the Securities Act. Of the remaining shares, 43,471,766 shares are available for sale, subject in some cases to volume and other restrictions of Rule 144 and Rule 701 under the Securities Act. 18,317,533 shares are subject to lock-up agreements with Goldman, Sachs & Co. and Morgan Stanley & Co. LLC that, subject to certain exceptions (including sales pursuant to existing sales plans adopted pursuant to Rule 10b5-1 of the Securities Exchange Act of 1934, as amended, or the Exchange Act), are restricted from sale through May 31, 2015. Goldman, Sachs & Co. and Morgan Stanley & Co. LLC may, in their sole discretion, permit our officers and directors, and the selling stockholders who are subject to lock-up agreements, to sell shares prior to the expiration of the lock-up agreements.

Additionally, the shares of common stock subject to outstanding options and restricted stock unit awards under our equity incentive plans and the shares reserved for future issuance under our equity incentive plans will become eligible for sale in the public market in the future, subject to certain legal and contractual limitations. See *Shares Eligible for Future Sale* for a more detailed description of sales that may occur in the future.

Certain holders of our common stock will have rights, subject to some conditions, to require us to file registration statements covering their shares or to include their shares in registration statements that we may file for our stockholders or ourselves.

Anti-takeover provisions in our charter documents and under Delaware law could make an acquisition of our company more difficult, limit attempts by our stockholders to replace or remove our current management and limit the market price of our common stock.

Provisions in our certificate of incorporation and bylaws may have the effect of delaying or preventing a change of control or changes in our management. Our certificate of incorporation and bylaws include provisions that:

authorize our board of directors to issue, without further action by the stockholders, shares of undesignated preferred stock with terms, rights, and preferences determined by our board of directors that may be senior to our common stock;

require that any action to be taken by our stockholders be effected at a duly called annual or special meeting and not by written consent;

specify that special meetings of our stockholders can be called only by our board of directors, the Chair of our board of directors, or our Chief Executive Officer;

establish an advance notice procedure for stockholder proposals to be brought before an annual meeting, including proposed nominations of persons for election to our board of directors;

establish that our board of directors is divided into three classes, Class I, Class II, and Class III, with each class serving three-year staggered terms;

prohibit cumulative voting in the election of directors;

provide that our directors may be removed only for cause;

provide that vacancies on our board of directors may be filled only by a majority of directors then in office, even though less than a quorum; and

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require the approval of our board of directors or the holders of at least seventy-five percent (75%) of our outstanding shares of capital stock to amend our bylaws and certain provisions of our certificate of incorporation.

These provisions may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace members of our board of directors, which is responsible for appointing the members of our management. In addition, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which generally prohibits a Delaware corporation from engaging in any of a broad range of business combinations with any interested stockholder for a period of three years following the date on which the stockholder became an interested stockholder. Any delay or prevention of a change of control transaction or changes in our management could cause the market price of our common stock to decline.

We are an emerging growth company and we cannot be certain if the reduced disclosure requirements applicable to emerging growth companies will make our common stock less attractive to investors.

We are an emerging growth company, as defined in the federal securities laws, and we may take advantage of certain exemptions from various reporting requirements that are applicable to other public companies that are not emerging growth companies including, but not limited to, not being required to comply with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements, and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and stockholder approval of any golden parachute payments not previously approved. We cannot predict if investors will find our common stock less attractive because we may rely on these exemptions. If some investors find our common stock less attractive as a result, there may be a less active trading market for our common stock and our stock price may be more volatile. We will remain an emerging growth company until the last day of the fiscal year following the five-year anniversary of the completion of our IPO, although if the market value of our common stock that is held by non-affiliates exceeds \$700 million as of the end of the second quarter of a fiscal year prior to the five-year anniversary, we would cease to be an emerging growth company as of the following December 31.

The requirements of being a public company may strain our resources, divert management's attention, and affect our ability to attract and retain executive management and qualified board members.

As a public company, we are subject to the reporting requirements of the Exchange Act, the Sarbanes-Oxley Act, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the listing requirements of the exchanges and other markets upon which our common stock is listed, and other applicable securities rules and regulations. Compliance with these rules and regulations increase our legal and financial compliance costs, make some activities more difficult, time-consuming, or costly, and increase demand on our systems and resources, particularly after we are no longer an emerging growth company. The Exchange Act requires, among other things, that we file annual, quarterly and current reports with respect to our business and operating results. The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal control over financial reporting. In order to maintain and, if required, improve our disclosure controls and procedures and internal control over financial reporting to meet this standard, significant resources and management oversight may be required. We are required to disclose changes made in our internal control and procedures on a quarterly basis and we are required to furnish a report by management on, among other things, the effectiveness of our internal control over financial reporting

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for the first fiscal year beginning after the effective date of our IPO. However, our independent registered public accounting firm is not required to formally audit and attest to the effectiveness of our internal control over financial reporting pursuant to Section 404 until the later of the year following our first annual report required to be filed with the SEC, or the date we are no longer an emerging growth company. As a result of the complexity involved in complying with the rules and regulations applicable to public companies, our management's attention may be diverted from other business concerns, which could adversely affect our business and operating results. Although we have already hired additional employees to assist us in complying with these requirements, we may need to hire more employees in the future or engage outside consultants, which will increase our operating expenses.

In addition, changing laws, regulations, and standards relating to corporate governance and public disclosure are creating uncertainty for public companies, increasing legal and financial compliance costs, and making some activities more time consuming. These laws, regulations, and standards are subject to varying interpretations, in many cases due to their lack of specificity, and, as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies. This could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We intend to invest substantial resources to comply with evolving laws, regulations, and standards, and this investment may result in increased general and administrative expenses and a diversion of management's time and attention from business operations to compliance activities. If our efforts to comply with new laws, regulations and standards differ from the activities intended by regulatory or governing bodies due to ambiguities related to their application and practice, regulatory authorities may initiate legal proceedings against us and our business may be adversely affected.

Being a public company and these new rules and regulations have made it more expensive for us to obtain director and officer liability insurance, and in the future we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. These factors could also make it more difficult for us to attract and retain qualified members of our board of directors, particularly to serve on our audit committee and compensation committee, and qualified executive officers.

As a result of disclosure of information in our filings with the SEC, our business and financial condition have become more visible, which we believe may result in threatened or actual litigation, including by competitors and other third parties. If such claims are successful, our business and operating results could be adversely affected, and even if the claims do not result in litigation or are resolved in our favor, these claims, and the time and resources necessary to resolve them, could divert the resources of our management and adversely affect our business and operating results.

We may invest or spend the proceeds of this offering in ways with which you may not agree or in ways which may not yield a return.

Our management will have considerable discretion in the application of the net proceeds of this offering that we receive, and you will not have the opportunity, as part of your investment decision, to assess whether these proceeds are being used appropriately. The net proceeds may be used for corporate purposes that do not increase the value of our business, which could cause our stock price to decline.

We do not intend to pay dividends on our common stock so any returns will be limited to changes in the value of our common stock.

We have never declared or paid any cash dividends on our common stock. We currently anticipate that we will retain future earnings for the development, operation, and expansion of our business, and do not anticipate declaring or paying any cash dividends for the foreseeable future. In

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addition, our ability to pay cash dividends on our common stock is restricted by our current credit facility and may be prohibited or limited by the terms of our current and future debt financing arrangements. Any return to stockholders will therefore be limited to the increase, if any, of our stock price, which may never occur.

If securities or industry analysts do not continue to publish research or publish inaccurate or unfavorable research about our business, our stock price and trading volume could decline.

The trading market for our common stock depends in part on the research and reports that securities or industry analysts publish about us or our business. If industry analysts cease coverage of us, the trading price for our common stock would be negatively affected. If one or more of the analysts who cover us downgrade our common stock or publish inaccurate or unfavorable research about our business, our common stock price would likely decline. If one or more of these analysts cease coverage of us or fail to publish reports on us regularly, demand for our common stock could decrease, which might cause our common stock price and trading volume to decline.

Our charter documents designate the Court of Chancery of the State of Delaware as the sole and exclusive forum for certain types of actions and proceedings that may be initiated by our stockholders, which could limit our stockholders' ability to obtain a favorable judicial forum for disputes with us or our directors, officers, or other employees.

Our certificate of incorporation and bylaws provide that, unless we consent in writing to the selection of an alternative forum, the Court of Chancery of the State of Delaware shall be the sole and exclusive forum for (A) any derivative action or proceeding brought on our behalf, (B) any action asserting a claim of breach of a fiduciary duty owed by any of our directors, officers or other employees to us or our stockholders, (C) any action asserting a claim arising pursuant to any provision of the Delaware General Corporation Law, our certificate of incorporation or our bylaws, or (D) any action asserting a claim against us governed by the internal affairs doctrine. Any person or entity purchasing or otherwise acquiring any interest in shares of our capital stock shall be deemed to have notice of and consented to the provisions of our certificate of incorporation described above. This choice of forum provision may limit a stockholder's ability to bring a claim in a judicial forum that it finds favorable for disputes with us or our directors, officers, or other employees, which may discourage such lawsuits against us and our directors, officers, and other employees. Alternatively, if a court were to find these provisions of our certificate of incorporation inapplicable to, or unenforceable in respect of, one or more of the specified types of actions or proceedings, we may incur additional costs associated with resolving such matters in other jurisdictions, which could adversely affect our business, financial condition, or results of operations.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

our future financial performance, including our revenue, cost of revenue, gross profit, operating expenses, ability to generate positive cash flow, and ability to achieve and maintain profitability;

the sufficiency of our cash and cash equivalents, and marketable securities to meet our liquidity needs;

our ability to attract and retain customers to use our customer service platform and live chat software, and to optimize the pricing for our customer service platform and live chat software;

the evolution of technology affecting our platform, services, and markets;

our ability to innovate and provide a superior customer experience;

our ability to successfully expand in our existing markets and into new markets;

the attraction and retention of qualified employees and key personnel;

our ability to effectively manage our growth and future expenses;

our ability to successfully offer our live chat software as a standalone service or further integrate it with our customer service platform;

our ability to maintain, protect, and enhance our intellectual property;

our ability to comply with modified or new laws and regulations applying to our business, including privacy and data security regulations;

worldwide economic conditions and their impact on information technology spending;

our ability to securely maintain customer data;

our ability to maintain and enhance our brand; and

our use of the net proceeds of this offering.

We caution you that the foregoing list may not contain all of the forward-looking statements made in this prospectus.

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

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circumstances reflected in the forward-looking statements will be achieved or occur, and actual results, events, or circumstances could differ materially from those described in the forward-looking statements.

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

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INDUSTRY AND MARKET DATA

This prospectus contains statistical data, estimates, and forecasts that are based on independent industry publications, such as those published by IDC, or other publicly available information, as well as other information based on our internal sources. Although we believe that the third-party sources referred to in this prospectus are reliable, neither we, the selling stockholders, nor the underwriters have independently verified the information provided by these third parties. While we are not aware of any misstatements regarding any third-party information presented in this prospectus, their estimates, in particular, as they relate to projections, involve numerous assumptions, are subject to risks and uncertainties, and are subject to change based on various factors, including those discussed under the section titled **Risk Factors** and elsewhere in this prospectus.

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USE OF PROCEEDS

We estimate that the net proceeds from the sale of shares of our common stock that we are selling in this offering will be approximately \$162.3 million, based on an offering price of \$22.75 per share, and after deducting underwriting discounts and commissions of \$7.4 million and estimated offering expenses of \$0.9 million payable by us. If the underwriters' option to purchase additional shares from us is exercised in full, we estimate that our net proceeds would be approximately \$190.1 million, after deducting underwriting discounts and commissions and estimated offering expenses payable by us.

We will not receive any proceeds from the sale of shares of our common stock by the selling stockholders.

The principal purposes of this offering are to raise additional capital and facilitate an orderly distribution of shares for the selling stockholders.

We intend to use the net proceeds that we receive from this offering for working capital or other general corporate purposes, including the further expansion and development of our customer service platform and live chat software, the development of new products and services, continued expansion of our sales and marketing capabilities, and international expansion. We may also use a portion of the net proceeds to acquire complementary businesses, products, services, or technologies. However, we have not entered into any agreements or commitments for any specific acquisitions at this time.

The amount and timing of our actual use of the net proceeds that we will receive from this offering will depend on numerous factors, including the cash used in or generated by our operations, the activities of our sales organization, the level of our international expansion efforts, the results of our product development efforts, and our technology acquisitions. Our management has discretion over many of these factors. Therefore, except as specified above, we are unable to estimate the amount of the net proceeds from this offering that will be used for any of the purposes described above. Accordingly, we will have broad discretion in using these proceeds. Pending the use of proceeds from this offering as described above, we plan to invest the net proceeds that we receive in this offering in short-term and intermediate-term interest-bearing obligations, investment-grade investments, certificates of deposit, or direct or guaranteed obligations of the U.S. government.

Table of Contents**MARKET PRICE OF COMMON STOCK**

Our common stock has been listed on the NYSE under the symbol ZEN since May 15, 2014, the date of our IPO. Prior to that date, there was no public trading market for our common stock. The following table sets forth for the periods indicated the high and low sales prices per share of our common stock as reported on the NYSE:

	High	Low
2014		
Second quarter (from May 15, 2014)	\$ 18.75	\$ 11.06
Third quarter	\$ 28.05	\$ 15.50
Fourth quarter	\$ 28.20	\$ 19.39
2015		
First quarter (through March 18, 2015)	\$ 26.37	\$ 21.27

On March 18, 2015, the last reported sale price of our common stock on the NYSE was \$23.30 per share. As of December 31, 2014, we had 117 stockholders of record of our common stock. The actual number of stockholders is greater than this number of stockholders of record, and includes stockholders who are beneficial owners, but whose shares are held in street name by brokers, trusts, and other nominees.

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DIVIDEND POLICY

We have never declared or paid any cash dividend on our capital stock. We currently intend to retain any future earnings and do not expect to pay any dividends in the foreseeable future. Any future determination to declare cash dividends will be made at the discretion of our board of directors, subject to applicable laws, and will depend on a number of factors, including our financial condition, operating results, capital requirements, contractual restrictions, general business conditions, and other factors that our board of directors may deem relevant. Currently, our credit facility prohibits the payment of any dividends without obtaining the lender's prior written consent, other than dividends payable solely in our common stock.

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The following table sets forth our cash and cash equivalents, and marketable securities, as well as our capitalization, as of December 31, 2014:

on an actual basis; and

on an as adjusted basis, giving effect to (A) the sale and issuance by us of 7,500,000 shares of common stock in this offering, based on the public offering price of \$22.75 per share, and after deducting the underwriting discounts and commissions and estimated offering expenses payable by us, and (B) the issuance of 20,000 shares of common stock to be acquired by a certain stockholder upon the exercise of options in order to sell those shares in this offering.

The as adjusted information set forth in the table below is illustrative only and will be adjusted based on the actual public offering price and other final terms of this offering. You should read this table together with our financial statements and related notes, and the sections titled Selected Consolidated Financial Data and Management's Discussion and Analysis of Financial Condition and Results of Operations that are included elsewhere in this prospectus.

	As of December 31, 2014	
	Actual	As Adjusted
	(In thousands, except share and per share data)	
Cash and cash equivalents	\$ 80,265	\$ 242,543
Marketable securities	42,204	42,204
Preferred stock, par value \$0.01 per share: 10,000,000 shares authorized, no shares issued and outstanding, actual and as adjusted		
Common stock, par value \$0.01 per share: 400,000,000 shares authorized, 76,111,753 shares issued, 75,577,076 shares outstanding, actual; 400,000,000 shares authorized, 83,631,753 shares issued, 83,097,076 shares outstanding, as adjusted	755	830
Additional paid-in capital	246,000	408,203
Accumulated other comprehensive loss	(528)	(528)
Accumulated deficit	(131,869)	(131,869)
Treasury stock at cost: 534,677 shares actual and as adjusted	(652)	(652)
Total stockholders' equity	113,706	275,984
Total capitalization	\$ 113,706	\$ 275,984

If the underwriters' option to purchase additional shares from us were exercised in full, as adjusted cash and cash equivalents, additional paid-in capital, total stockholders' equity, and shares issued and outstanding as of December 31,

2014 would be \$270.4 million, \$436.0 million, \$303.8 million, and 84,376,576 shares, respectively.

The as adjusted column in the table above excludes the following:

12,044,546 shares of our common stock issuable upon the exercise of options to purchase common stock that were outstanding as of December 31, 2014 with a weighted-average exercise price of \$7.39 per share (other than 20,000 shares to be issued upon exercise of an option to purchase common stock by a certain stockholder and sold in this offering);

3,063,455 shares of our common stock subject to restricted stock units outstanding as of December 31, 2014;

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1,318,800 shares of our common stock issuable upon the exercise of options to purchase common stock granted after December 31, 2014 through February 28, 2015, with a weighted-average exercise price of \$24.75 per share;

1,852,932 shares of our common stock subject to restricted stock units granted after December 31, 2014 through February 28, 2015;

7,559,573 shares of our common stock reserved for future issuance under our 2014 Stock Option and Incentive Plan as of December 31, 2014;

3,197,419 shares of our common stock reserved for future issuance under our 2014 Employee Stock Purchase Plan as of December 31, 2014; and

any shares of our common stock that become available subsequent to this offering under our 2014 Stock Option and Incentive Plan and 2014 Employee Stock Purchase Plan pursuant to provisions thereof that automatically increase the share reserves under such plans each year, as more fully described in Executive Compensation Employee Benefit and Stock Plans.

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If you invest in our common stock in this offering, your ownership interest will be diluted to the extent of the difference between the public offering price per share of our common stock and the as adjusted net tangible book value per share of our common stock immediately after this offering. Net tangible book value dilution per share to new investors represents the difference between the amount per share paid by purchasers of shares of common stock in this offering and the as adjusted net tangible book value per share of common stock immediately after the completion of this offering.

Net tangible book value per share is determined by dividing our total tangible assets less our total liabilities by the number of shares of common stock outstanding. Our historical net tangible book value as of December 31, 2014 was \$85.9 million, or \$1.14 per share. Our historical net tangible book value excludes \$14.2 million of goodwill and intangible assets, net and \$13.6 million of capitalized internal-use software, net of amortization.

After giving effect to (A) the sale by us of 7,500,000 shares of common stock in this offering at the public offering price of \$22.75 per share, and after deducting underwriting discounts and commissions of \$7.4 million and estimated offering expenses of \$0.9 million payable by us, and (B) the issuance of 20,000 shares of common stock to be acquired by a certain stockholder upon the exercise of options in order to sell those shares in this offering, our as adjusted net tangible book value as of December 31, 2014 would have been \$248.2 million, or \$2.99 per share. This represents an immediate increase in net tangible book value of \$1.85 per share to our existing stockholders and an immediate dilution in net tangible book value of \$19.76 per share to investors purchasing shares of common stock in this offering at the public offering price. The following table illustrates this dilution:

Public offering price per share	\$ 22.75
Net tangible book value per share as of December 31, 2014	\$ 1.14
Increase in net tangible book value per share attributable to new investors in this offering	1.85
As adjusted net tangible book value per share immediately after this offering	2.99
Dilution in net tangible book value share to new investors in this offering	\$ 19.76

If the underwriters exercise their option to purchase additional shares from us in full, the as adjusted net tangible book value per share of our common stock immediately after this offering would be \$3.27 per share, and the dilution in net tangible book value per share to new investors in this offering would be \$19.48 per share.

The following table presents, on an as adjusted basis as of December 31, 2014, the differences between the existing stockholders (including 20,000 shares to be sold in this offering by a certain stockholder upon the exercise of options) and the new investors purchasing shares of our common stock in this offering with respect to the number of shares purchased from us, the total consideration paid or to be paid to us, which includes net proceeds received from the issuance of common stock, cash received from the exercise of stock options, and the average price per share paid or to be paid to us at the public offering price of \$22.75 per share, before deducting underwriting discounts and commissions and estimated offering expenses payable by us:

Shares Purchased	Total Consideration
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	Number	Percent	Number	Percent	Average Price Per Share
Existing stockholders	75,597,076	91.0%	\$ 201,065,437	54.1%	\$ 2.66
New investors	7,500,000	9.0%	\$ 170,625,000	45.9%	\$ 22.75
Totals	83,097,076	100.0%	\$ 371,690,437	100.0%	\$ 4.47

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Except as otherwise indicated, the above discussion and tables assume no exercise of the underwriters' option to purchase additional shares. If the underwriters exercise their option to purchase additional shares from us in full, the total consideration paid by new investors and total consideration paid by all stockholders would increase by \$29.1 million. Following such exercise, our existing stockholders would own 89.6% and our new investors would own 10.4% of the total number of shares of our common stock outstanding upon the completion of this offering.

The number of shares of our common stock to be outstanding after this offering is based on 75,577,076 shares of our common stock outstanding as of December 31, 2014 and 20,000 shares to be issued upon exercise of an option to purchase common stock by a certain selling stockholder and sold in this offering, and excludes:

12,044,546 shares of our common stock issuable upon the exercise of options to purchase common stock that were outstanding as of December 31, 2014 with a weighted-average exercise price of \$7.39 per share (other than 20,000 shares to be issued upon exercise of an option to purchase common stock by a certain selling stockholder and sold in this offering);

3,063,455 shares of our common stock subject to restricted stock units outstanding as of December 31, 2014;

1,318,800 shares of our common stock issuable upon the exercise of options to purchase common stock granted after December 31, 2014 through February 28, 2015 with a weighted-average exercise price of \$24.75 per share;

1,852,932 shares of our common stock subject to restricted stock units granted after December 31, 2014 through February 28, 2015;

7,559,573 shares of our common stock reserved for future issuance under our 2014 Stock Option and Incentive Plan as of December 31, 2014;

3,197,419 shares of our common stock reserved for future issuance under our 2014 Employee Stock Purchase Plan as of December 31, 2014; and

any shares of our common stock that become available subsequent to this offering under our 2014 Stock Option and Incentive Plan and 2014 Employee Stock Purchase Plan pursuant to provisions thereof that automatically increase the share reserves under such plans each year, as more fully described in Executive Compensation, Employee Benefit and Stock Plans.

Table of Contents**SELECTED CONSOLIDATED FINANCIAL DATA**

The following consolidated statements of operations for the years ended December 31, 2012, 2013, and 2014 and the selected consolidated balance sheet data as of December 31, 2013 and 2014 are derived from the audited consolidated financial statements that are included elsewhere in this prospectus. Our historical results are not necessarily indicative of the results to be expected in the future. You should read the following selected consolidated financial data below in conjunction with the section titled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and related notes included elsewhere in this prospectus.

	Year Ended December 31,		
	2012	2013	2014
(In thousands, except per share data)			
Consolidated Statements of Operations Data:			
Revenue	\$ 38,228	\$ 72,045	\$ 127,049
Cost of revenue ⁽¹⁾	13,253	24,531	46,047
Gross profit	24,975	47,514	81,002
Operating expenses ⁽¹⁾			
Research and development	14,816	15,288	36,403
Sales and marketing	22,749	37,622	77,875
General and administrative	11,558	16,437	32,869
Total operating expenses	49,123	69,347	147,147
Operating loss	(24,148)	(21,833)	(66,145)
Other expense, net	(96)	(517)	(1,533)
Loss before provision for (benefit from) income taxes	(24,244)	(22,350)	(67,678)
Provision for (benefit from) income taxes	121	221	(263)
Net loss	(24,365)	(22,571)	(67,415)
Accretion of redeemable convertible preferred stock	(50)	(49)	(18)
Deemed dividend to investors in relation to the tender offer	(8,326)		
Net loss attributable to common stockholders	\$ (32,741)	\$ (22,620)	\$ (67,433)
Net loss per share attributable to common stockholders, basic and diluted ⁽²⁾	\$ (1.67)	\$ (1.04)	\$ (1.26)
Weighted-average shares used to compute net loss per share attributable to common stockholders, basic and diluted ⁽²⁾	19,629	21,674	53,571

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

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

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- (2) See Note 10 of the Notes to our Consolidated Financial Statements included elsewhere in this prospectus for an explanation of the method used to calculate basic and diluted net loss per share attributable to common stockholders and the weighted-average number of shares used in the computation of the per share amounts.

	As of December 31,	
	2013	2014
	(In thousands)	
Consolidated Balance Sheet Data:		
Cash and cash equivalents	\$ 53,725	\$ 80,265
Marketable securities	9,889	42,204
Working capital	31,706	60,856
Property and equipment, net	15,431	41,895
Goodwill and intangible assets, net		14,152
Total assets	92,736	205,788
Deferred revenue	29,048	51,731
Credit facility	23,760	6,952
Total liabilities	67,643	92,082
Redeemable convertible preferred stock	71,369	
Stockholders' equity (deficit)	(46,276)	113,706

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**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 the section titled "Selected Consolidated Financial Data" and consolidated financial statements and related notes thereto included elsewhere in this prospectus. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those discussed below. Factors that could cause or contribute to such differences include, but are not limited to, those identified below and those discussed in the section titled "Risk Factors" included elsewhere in this prospectus.

Overview

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

Our business model is designed to drive organic growth, leverage positive word-of-mouth, and remove friction from the evaluation and purchasing process. We offer a range of subscription account plans for our customer service platform and live chat software that vary in pricing based on functionality, type, and, for our customer service platform, the amount of product support we offer and service-level guarantees. The majority of our customers find us online and subscribe to our customer service platform and live chat software directly from our websites. During the three months ended December 31, 2014, approximately 64% of our qualified sales leads generated online, and approximately 62% of the total qualified sales leads for our customer service platform, came from organic search, customer referrals, and other unpaid sources. We use tools provided by third-parties to measure the percentage of qualified sales leads generated online and of the total qualified leads for our customer service platform that came from organic search, customer referrals, and other unpaid sources. While we expect that a shift in these values is generally related to a change in the mix of qualified sales leads from paid and unpaid sources, there may be instances where changes in these values are a result of changes by the third-party providers to the tools used to measure these values or the underlying data used by such tools. During the three months ended December 31, 2014, we experienced a decrease in the percentage of qualified sales leads generated online and of the total qualified leads for our customer service platform that came from organic search, customer referrals, and other unpaid sources as compared to prior periods. We believe that our increased investment in our field sales and marketing efforts and other paid sources of qualified leads contributed significantly to this shift. As we continue to invest in field marketing efforts and adopt new marketing initiatives, we expect that the percentage of qualified sales leads generated from organic search, customer referrals, and other unpaid sources may continue to decline.

Our largest source of qualified sales leads is free trials of our customer service platform commenced by prospects. For larger organizations, our sales team focuses on a land and expand strategy, which leverages this grassroots adoption and seeks to expand our footprint within organizations. More recently we have begun to develop our field sales and marketing teams primarily responsible for lead discovery, qualification, and account management for larger organizations. Many of our existing customers to date have been small to medium sized organizations that make purchasing decisions with limited interaction with our sales or other personnel; as we continue to focus on and become more dependent on sales to larger organizations and increase our investment in paid

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sources of qualified leads, we expect the percentage of qualified leads that come from unpaid sources, such as organic search and customer referrals, to decrease and our sales cycles to lengthen and become less predictable.

For the years ended December 31, 2012, 2013, and 2014, our revenue was \$38.2 million, \$72.0 million, and \$127.0 million, respectively, representing an 88% annual growth rate from 2012 to 2013 and a 76% annual growth rate from 2013 to 2014. For the years ended December 31, 2012, 2013, and 2014 we derived \$15.8 million, or 41%, \$29.6 million, or 41%, and \$54.8 million, or 43%, respectively, of our revenue from customers located outside of the United States. We expect that the rate of growth in our revenue will decline as our business scales, even if our revenue continues to grow in absolute terms. For the years ended December 31, 2012, 2013, and 2014, we generated net losses of \$24.4 million, \$22.6 million, and \$67.4 million, respectively. We intend to continue to invest aggressively to drive continued growth and market leadership.

The growth of our business and our future success depends on many factors, including our ability to continue to innovate, maintain our leadership in the SMB market, expand our enterprise customer base, and increase our global customer footprint. While these areas represent significant opportunities for us, we also face significant risks and challenges that we must successfully address in order to sustain the growth of our business and improve our operating results. We anticipate that we will expand our operations and headcount in the near term. The expected addition of new personnel and the investments that we anticipate will be necessary to manage our anticipated growth, including investments in leasehold improvements and related fixed assets, will make it more difficult for us to achieve profitability. Many of these investments will occur in advance of experiencing any direct benefit and will make it difficult to determine if we are allocating our resources efficiently.

We have focused on rapidly growing our business and plan to continue to invest for long-term growth. We expect to continue to make significant upfront investments in our self-managed colocation data center infrastructure and additional personnel to support our growth. The amount and timing of these upfront infrastructure investments will vary based on our estimates of projected growth and the scale of such deployments. We also expect to continue to make significant investments in our customer support organization including expanding our product support and professional services teams. Over time, we anticipate that we will gain economies of scale by utilizing added capacity within our self-managed colocation data centers and reducing the need for direct incremental personnel costs resulting from growth in our number of customers. As a result, we expect our gross margin to improve in the future, although our gross margin may fluctuate from period to period as our revenue fluctuates and as a result of the timing and amount of investments to expand our product support team, investments in additional personnel, equipment, and facilities to support our platform architecture, increased share-based compensation expenses, as well as the amortization of costs associated with capitalized internal-use software and purchased intangible assets.

We expect our operating expenses to continue to increase in absolute dollars in future periods. We have invested, and expect to continue to invest, in our software development efforts to introduce new products and broaden our customer service platform's functionality. We plan to continue to expand our sales and marketing organizations, particularly in connection with our efforts to expand our enterprise customer base. We also expect to incur additional general and administrative costs in order to support the growth of our business and the infrastructure required with our obligations as a public company.

Key Business Metrics

We review a number of operating metrics, including the following key metrics, to evaluate our business, measure our performance, identify trends affecting our business, formulate business plans, and make strategic decisions.

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Number of Paid Customer Accounts. We believe that our ability to increase our number of paid accounts on our customer service platform and live chat software is an indicator of our market penetration, the growth of our business, and our potential future business opportunities. We define the number of paid customer accounts as the sum of the number of accounts on our customer service platform, exclusive of our Starter plan, free trials or other free services, and the number of accounts using our live chat software, exclusive of free trials or other free services, each as of the end of the period and as identified by a unique account identifier. Use of our customer service platform and live chat software requires separate subscriptions and each of these accounts is treated as a separate paid customer account. Existing customers may also expand their utilization of our customer service platform or live chat software by adding new accounts and a single consolidated organization or customer may have multiple accounts across each of our customer service platform and live chat software to service separate subsidiaries, divisions, or work processes. Each of these accounts is also treated as a separate paid customer account. An increase in the number of paid customer accounts generally correlates to an increase in the number of authorized agents licensed to use our platform, which directly affects our revenue and results of operations. We view growth in this metric as a measure of our success in converting new sales opportunities. We had approximately 52,500 paid customer accounts as of December 31, 2014, including approximately 27,600 paid customer accounts on our customer service platform and approximately 24,900 paid customer accounts using our live chat software. As the total number of paid customer accounts increases, we expect the rate of growth in the number of paid customer accounts to decline.

Prior to December 31, 2014, we measured the number of customer accounts on our customer service platform, exclusive of free trials or other free services, but including our low cost Starter plan, as of the end of specified periods as identified by a unique account identifier. We believe that including the number of paid customer accounts for both our customer service platform and our live chat software in the number of paid customer accounts, while eliminating our Starter plan from this metric, provides an operating metric that reflects the customer accounts that have the most impact on our operating results.

The number of paid customer accounts, as currently calculated, and the number of customer accounts, as previously calculated, as of the last day of each quarter in the fiscal year ended December 31, 2014 is presented below for comparative purposes.

	March 31, 2014	June 30, 2014	As of September 30, 2014	December 31, 2014
Paid customer accounts on our customer service platform (approximate)	22,100	24,000	25,900	27,600
Paid customer accounts using our live chat software (approximate)	17,800	20,100	22,500	24,900
Total paid customer accounts (approximate)	39,900	44,100	48,400	52,500
Customer accounts (as previously calculated)	42,685	45,740	48,763	51,721

Dollar-Based Net Expansion Rate. Our ability to generate revenue is dependent upon our ability to maintain our relationships with our customers and to increase their utilization of our customer service platform. We believe we can achieve this by focusing on delivering value and functionality that retains our existing customers, expands the number of authorized agents associated with an existing paid customer account on our customer service platform, and results in upgrades to higher-priced subscription plans. Maintaining customer relationships allows us to sustain and increase

revenue to the extent customers maintain or increase the number of authorized agents licensed to use our customer service platform. We

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assess our performance in this area by measuring our dollar-based net expansion rate. Our dollar-based net expansion rate provides a measurement of our ability to increase revenue across our existing customer base through expansion of authorized agents associated with a paid customer account on our customer service platform, and upgrades in subscription plan, as offset by churn, contraction in authorized agents associated with a paid customer account on our customer service platform, and downgrades in subscription plans. We do not currently incorporate operating metrics associated with our live chat software into our measurement of dollar-based net expansion rate.

Our dollar-based net expansion rate is based upon our monthly recurring revenue for a set of paid customer accounts on our customer service platform. Monthly recurring revenue for a paid customer account is a legal and contractual determination made by assessing the contractual terms of each paid customer account, as of the date of determination, as to the revenue we expect to generate in the next monthly period for that paid customer account, assuming no changes to the subscription and without taking into account any one-time discounts or any platform usage above the subscription base, if any, that may be applicable to such subscription. Monthly recurring revenue is not determined by reference to historical revenue, deferred revenue or any other United States generally accepted accounting principles, or GAAP, financial measure over any period. It is forward-looking and contractually derived as of the date of determination.

We calculate our dollar-based net expansion rate by dividing our retained revenue net of contraction and churn by our base revenue. We define our base revenue as the aggregate monthly recurring revenue of the paid customer accounts on our customer service platform as of the date one year prior to the date of calculation. We define our retained revenue net of contraction and churn as the aggregate monthly recurring revenue of the same customer base included in our measure of base revenue at the end of the annual period being measured. Our dollar-based net expansion rate is also adjusted to eliminate the effect of certain activities that we identify involving the transfer of agents between paid customer accounts, consolidation of customer accounts, or the split of a single paid customer account into multiple paid customer accounts. In addition, our dollar-based net expansion rate is adjusted to include paid customer accounts in the customer base used to determine retained revenue net of contraction and churn that share common corporate information with customers in the customer base that is used to determine our base revenue. Giving effect to this consolidation results in our dollar-based net expansion rate being calculated across approximately 25,900 customers, as compared to the approximately 27,600 total paid customer accounts as of December 31, 2014. While not material, we believe the failure to account for these activities would otherwise skew our dollar-based net expansion metrics associated with customers that maintain multiple paid customer accounts on our customer service platform. Our measurement of the percentage of monthly recurring revenue for our customer service platform generated by customers with 100 or more agents on our customer service platform similarly includes adjustments to aggregate paid customer accounts that share common corporate information.

As of December 31, 2014, we adjusted our calculation of dollar-based net expansion rate to exclude customer accounts on the low cost Starter plan for our customer service platform. In prior periods, we presented a dollar-based net expansion rate, or the historic dollar-based net expansion rate, which included customer accounts on our low-cost Starter subscription plan for our customer service platform. We calculated the historic dollar-based net expansion rate in the same manner as our current calculation of the dollar-based net expansion rate, with the exception that the customer base used in the determination of retained revenue net of contraction and churn and base revenue included the customer accounts on our low cost Starter subscription plan while our current calculation of dollar-based net expansion rate excludes these accounts. While relatively insignificant, we believe that the exclusion of subscriptions to our low cost Starter plan from our calculation of net dollar expansion provides a more useful measure of the effectiveness of resources we deploy to expand our relationships with existing customers.

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Our dollar-based net expansion rate was 120% as of December 31, 2014. We expect our dollar-based net expansion rate to decline over time as our aggregate monthly recurring revenue grows.

The operating metric for our current calculation of dollar-based net expansion rate and our historic dollar-based net expansion rate for the last day of each quarter in the fiscal year ended December 31, 2014 is presented below for comparative purposes.

	March 31, 2014	June 30, 2014	As of September 30, 2014	December 31, 2014
Current calculation of dollar-based net expansion rate	121%	120%	121%	120%
Historic dollar-based net expansion rate	123%	122%	123%	122%

Components of Results of Operations**Revenue**

We derive substantially all of our revenue from subscription services, which are comprised of subscription fees from customer accounts on our customer service platform and, to a lesser extent, live chat software. Each subscription may have multiple authorized users, and we refer to each such user as an agent. The number of agents ranges from one to thousands for various customer accounts. Our pricing is generally established on a per agent basis. We offer a range of subscription account plans for our customer service platform and live chat software that vary in pricing based on functionality, type and, for our customer service platform, the amount of product support we offer and service-level guarantees. Certain arrangements provide for incremental fees above a fixed maximum number of monthly agents during the subscription term. We sell subscription services under contractual agreements that vary in length, ranging between one month and multiple years, with the majority of subscriptions having a term of either one month or one year.

Subscription fees are generally non-refundable regardless of the actual use of the service. Subscription revenue is typically affected by the number of customer accounts, number of agents, and the type of plan purchased by our customers, and is recognized ratably over the contractual term of the arrangement beginning on the date that our services are made available to our customers. Subscription services purchased online are typically paid for via a credit card on the date of purchase while subscription services purchased through our internal sales organization are generally billed with monthly, quarterly, or annual payment frequency. Due to our mixed contract lengths and billing frequencies, the annualized value of the arrangements we enter into with our customers may not be fully reflected in deferred revenue at any single point in time. Accordingly, we do not believe that the change in deferred revenue for any period is an accurate indicator of future revenue for a given period of time.

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

Cost of Revenue, Gross Margin, and Operating Expenses

Cost of Revenue. Cost of revenue consists primarily of personnel costs (including salaries, share-based compensation, and benefits) for employees associated with our platform infrastructure and our product support

organizations, depreciation and other expenses associated with our self-managed colocation data centers, data center costs related to hosting our platform, amortization expense associated with capitalized internal-use software, payment processing fees, amortization

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expense associated with purchased intangible assets, and allocated shared costs. We allocate shared costs such as facilities, shared information technology and security costs, and employee benefit costs to all departments based on headcount. As such, allocated shared costs are reflected in cost of revenue and each operating expense category.

We currently utilize third-party managed hosting facilities located in North America, Europe, and Asia and self-managed colocation data centers in which we manage our own network equipment and systems. We currently operate in three such self-managed colocation data centers located in California, Virginia, and Ireland. In order to improve our long-term cost efficiency, we intend to expand our operations in these and establish other self-managed colocation data centers over time. Our live chat software was originally hosted in a managed hosting facility in Florida and in January 2015, we migrated all accounts to our self-managed colocation facility in Ireland. In certain markets and for certain products, we may elect not to pursue our self-managed colocation strategy, depending on individual market dynamics.

We intend to continue to invest additional resources in our platform infrastructure and our product support organizations. As we continue to invest in technology innovation, we expect to have increased capitalized internal-use software costs and related amortization. We expect our investment in technology to not only expand the capability of our customer service platform and live chat software but also increase the efficiency of how we deliver our customer service platform and live chat software, enabling us to improve our gross margin over time. The level and timing of investment in these areas could affect our cost of revenue in the future.

Gross Margin. Gross margin is gross profit expressed as a percentage of revenue. Our gross margin may fluctuate from period to period as our revenue fluctuates and as a result of the timing and amount of investments to expand our product support and professional services teams, investments in additional personnel, equipment, and facilities to support our platform architecture, increased share-based compensation expenses, as well as the amortization of costs associated with capitalized internal-use software and purchased intangible assets.

Research and Development. Research and development expenses consist primarily of personnel costs (including salaries, share-based compensation, and benefits) for employees associated with our research and development organization and allocated shared costs.

We focus our research and development efforts on the continued development of our customer service platform and live chat software, including the development and deployment of new features and functionality and enhancements to our software architecture. We expect that, in the future, research and development expenses will increase in absolute dollars. However, we expect our research and development expenses to decrease modestly as a percentage of our revenue in the long-term, although this may fluctuate from period to period depending on fluctuations in revenue and the timing and extent of our research and development expenses. In particular, these expenses are sensitive to the impact of share-based compensation which may cause these expenses to fluctuate from period to period.

Sales and Marketing. Sales and marketing expenses consist of personnel costs (including salaries, commissions, share-based compensation, and benefits) for employees associated with our sales and marketing organizations, costs of marketing activities, and allocated shared costs. Marketing activities include online lead generation, advertising, promotional events, and public and community relations. Sales commissions and other incremental costs to acquire contracts are expensed as incurred.

We focus our sales and marketing efforts on generating awareness of our company, creating sales leads, establishing and promoting our brand, and cultivating a community of successful and vocal

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customers. We plan to continue investing in sales and marketing by increasing the number of direct sales employees, developing our field sales and marketing teams, expanding our indirect sales channels, building brand awareness, and sponsoring additional marketing events, which we believe will enable us to add new customers and increase penetration within our existing customer base. Because we do not have a long history of undertaking or growing many of these activities, we cannot predict whether, or to what extent, our revenue will increase as we invest in these strategies. We expect our sales and marketing expenses to continue to increase in absolute dollars and continue to be our largest operating expense category for the foreseeable future. Our sales and marketing expenses as a percentage of our revenue over time may fluctuate from period to period depending on fluctuations in revenue and the timing and extent of our sales and marketing expenses. In particular, these expenses are sensitive to the impact of share-based compensation which may cause these expenses to fluctuate from period to period.

General and Administrative. General and administrative expenses consist primarily of personnel costs (including salaries, share-based compensation, and benefits) for our executive, finance, legal, human resources, and other administrative employees. In addition, general and administrative expenses include fees for third-party professional services, including legal, tax, and accounting services, and other corporate expenses and allocated shared costs.

We expect to incur incremental costs associated with supporting the growth of our business, both in terms of size and geographic expansion, and the infrastructure required to be a public company. Such costs include increases in our finance, legal, and human resources personnel, additional legal, tax, and accounting services fees, insurance costs, board of directors compensation and costs of achieving and maintaining compliance with Section 404 of the Sarbanes-Oxley Act, and other costs associated with being a public company. As a result, we expect our general and administrative expenses to continue to increase in absolute dollars for the foreseeable future. However, we expect our general and administrative expenses to decrease modestly as a percentage of our revenue in the long-term, although this may fluctuate from period to period depending on fluctuations in revenue and the timing and extent of our general and administrative expenses. In particular, these expenses are sensitive to the impact of share-based compensation which may cause these expenses to fluctuate from period to period.

Other Expense, Net

Other expense, net consists primarily of interest expense associated with our credit facility and foreign currency losses, offset by interest income from marketable securities.

Provision for (Benefit from) Income Taxes

Provision for (benefit from) income taxes consists of federal and state income taxes in the United States and income taxes in certain foreign jurisdictions. See Note 11 of the Notes to our Consolidated Financial Statements included elsewhere in this prospectus.

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The following tables set forth our results of operations for the periods presented in dollars and as a percentage of our revenue:

	Year Ended December 31,		
	2012	2013	2014
	(In thousands)		
Revenue	\$ 38,228	\$ 72,045	\$ 127,049
Cost of revenue ⁽¹⁾	13,253	24,531	46,047
Gross profit	24,975	47,514	81,002
Operating expenses ⁽¹⁾			
Research and development	14,816	15,288	36,403
Sales and marketing	22,749	37,622	77,875
General and administrative	11,558	16,437	32,869
Total operating expenses	49,123	69,347	147,147
Operating loss	(24,148)	(21,833)	(66,145)
Other expense, net	(96)	(517)	(1,533)
Loss before provision for (benefit from) income taxes	(24,244)	(22,350)	(67,678)
Provision for (benefit from) income taxes	121	221	(263)
Net loss	\$ (24,365)	\$ (22,571)	\$ (67,415)

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

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

	Year Ended December 31,		
	2012	2013	2014
	(As a percentage of revenue)		
Revenue	100.0%	100.0%	100.0%
Cost of revenue ⁽¹⁾	34.7	34.0	36.2

Gross profit	65.3	66.0	63.8
Operating expenses ⁽¹⁾			
Research and development	38.8	21.2	28.7
Sales and marketing	59.5	52.2	61.3
General and administrative	30.2	22.8	25.9
Total operating expenses	128.5	96.3	115.8
Operating loss	(63.2)	(30.3)	(52.1)
Other expense, net	(0.3)	(0.7)	(1.2)
Loss before provision for (benefit from) income taxes	(63.4)	(31.0)	(53.3)
Provision for (benefit from) income taxes	0.3	0.3	(0.2)
Net loss	(63.7)%	(31.3)%	(53.1)%

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

	Year Ended December 31,		
	2012	2013	2014
	(As a percentage of revenue)		
Cost of revenue	0.3%	0.4%	1.9%
Research and development	10.8	0.9	8.6
Sales and marketing	3.4	1.7	8.4
General and administrative	10.7	3.8	6.4

Prior to our IPO, we granted restricted stock units and certain stock options with both a service condition and a performance condition, or Performance Awards. The service condition for substantially all of the Performance Awards is satisfied over four years. The performance condition was satisfied upon the effectiveness of the registration statement related to our IPO. No share-based compensation expense had been recognized for the Performance Awards prior to our IPO. Upon the satisfaction of the performance condition in May 2014, we recognized a cumulative share-based compensation expense for the portion of the Performance Awards that had met the service condition. For the year ended December 31, 2014, share-based compensation expense related to the Performance Awards was \$12.7 million, including \$0.9 million in cost of revenue, \$7.8 million in research and development, \$2.4 million in sales and marketing, and \$1.6 million in general and administrative expenses, respectively.

In September 2012, in connection with our sale of the Series D redeemable convertible preferred stock, the purchasers of the Series D redeemable convertible preferred stock conducted a tender offer to acquire approximately 4.0 million shares of common stock from employees, former employees, and other existing investors. As a result of this transaction, we recorded a total of \$8.6 million in share-based compensation expense for the difference between the price paid for shares held by our employees and former employee stockholders and the estimated fair market value on the date of the transaction. Of the total share-based compensation expense, we recorded \$20,000, \$3.9 million, \$1.0 million, and \$3.7 million in cost of revenue, research and development, sales and marketing, and general and administrative expenses, respectively.

Revenue

	Year Ended December 31,			2012	2013
	2012	2013	2014	to 2013	to 2014
	(In thousands, except percentages)			% Change	% Change
Revenue	\$ 38,228	\$ 72,045	\$ 127,049	88%	76%

Revenue increased \$33.8 million, or 88%, in 2013 compared to 2012. Of the total increase in revenue, \$13.5 million, or 40%, was attributable to revenue from new accounts acquired from January 1, 2013 through December 31, 2013, net of churn and contraction, and \$20.3 million, or 60%, was attributable to revenue from accounts existing on or before December 31, 2012, net of churn and contraction.

Revenue increased \$55.0 million, or 76%, in 2014 compared to 2013. Of the total increase in revenue, \$23.2 million, or 42%, was attributable to revenue from new accounts acquired from January 1, 2014 through December 31, 2014, net of churn and contraction, and \$31.8 million, or 58%, was attributable to revenue from accounts existing on or

before December 31, 2013, net of churn and contraction.

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Revenue from customer accounts that are invoiced in aggregate is treated as being generated from a single customer account. The acquisition date of customer accounts that are invoiced in aggregate is determined using the establishment date of the earliest customer account.

Cost of Revenue and Gross Margin

	Year Ended December 31,			2012	2013
	2012	2013	2014	to 2013 % Change	to 2014 % Change
	(In thousands, except percentages)				
Cost of revenue	\$ 13,253	\$ 24,531	\$ 46,047	85%	88%
Gross margin	65.3%	66.0%	63.8%		

Cost of revenue increased \$11.3 million, or 85%, in 2013 compared to 2012. The overall increase was due to increased employee compensation-related costs of \$4.4 million associated with our substantial increase in headcount, increased depreciation expense and other costs associated with our self-managed colocation data centers of \$2.1 million driven by our investments in building out and increasing capacity within our self-managed colocation data centers, and increased hosting fees of \$1.2 million as we increased data center capacity to support our growth. Further contributing to the increase was \$0.9 million in amortization expense associated with capitalized internal-use software, an increase of \$0.4 million in payment processing fees and an increase in allocated shared costs of \$0.9 million.

Our gross margin increased to 66.0% in 2013, as compared to 65.3% in 2012. The increase in gross margin was primarily driven by economies of scale in our operations during the period reflected by our ability to maintain growth in costs of revenue at a level lower than our revenue growth.

Cost of revenue increased \$21.5 million, or 88%, in 2014 compared to 2013. The overall increase was primarily due to increased employee compensation-related costs of \$9.5 million associated with our substantial increase in headcount, the share-based compensation expense related to the Performance Awards described above, increased depreciation expense and other costs associated with our self-managed colocation data centers of \$2.9 million driven by our investments in building out and increasing capacity within our self-managed colocation data centers, and increased amortization expense associated with capitalized internal-use software of \$1.5 million as we continue to develop additional features and functionalities of our platform. Further contributing to the increase was \$1.2 million in hosting fees as we increased data center capacity to support our growth, an increase of \$1.2 million in amortization expense of acquired intangibles in connection with our acquisition of Zopim in the three months ended March 31, 2014, and an increase of \$3.4 million in allocated shared costs primarily due to increased facilities expenses.

Our gross margin decreased to 63.8% in 2014, as compared to 66.0% in 2013. The decrease was primarily due to a 2.6% increase in employee-related compensation costs, driven by increased share-based compensation expense, and a 1.1% increase in allocated shared costs as a percentage of revenue, offset by a 1.7% decrease in hosting fees as a percentage of revenue driven by efficiency realized from our investments in building out our self-managed colocation data centers.

Operating Expenses**Research and Development Expenses**

	Year Ended December 31,			2012	2013
	2012	2013	2014	to 2013 % Change	to 2014 % Change
	(In thousands, except percentages)				
Research and development	\$ 14,816	\$ 15,288	\$ 36,403	3%	138%

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Research and development expenses increased \$0.5 million, or 3%, in 2013 compared to 2012. The increase was primarily due to an increase of \$3.3 million in employee compensation-related costs, driven by our substantial increase in headcount, and an increase of \$1.2 million in allocated shared costs. The 2013 increase was largely offset by the \$3.9 million charge recorded in connection with the 2012 tender offer described above.

Research and development expenses increased \$21.1 million, or 138%, in 2014 compared to 2013. The increase was primarily due to an increase of \$17.4 million in employee compensation-related costs, driven by our substantial increase in headcount and the share-based compensation expense related to the Performance Awards described above, and an increase of \$2.9 million in allocated shared costs.

Sales and Marketing Expenses

	Year Ended December 31,			2012	2013
	2012	2013	2014	to 2013 % Change	to 2014 % Change
	(In thousands, except percentages)				
Sales and marketing	\$ 22,749	\$ 37,622	\$ 77,875	65%	107%

Sales and marketing expenses increased \$14.9 million, or 65%, in 2013 compared to 2012. The overall increase was primarily due to increased employee compensation-related costs of \$9.4 million and increased marketing program costs of \$3.3 million. The 2013 increase in employee compensation-related costs, mainly consisting of salaries, sales commissions, and share-based compensation expense, was driven by the substantial increase in our sales force. The 2013 increase in marketing program costs was primarily driven by increases in online lead generation marketing programs to drive the adoption of our platform. Additionally, allocated shared costs increased \$2.1 million. The 2013 increase was partially offset by the \$1.0 million charge recorded in connection with the 2012 tender offer described above.

Sales and marketing expenses increased \$40.3 million, or 107%, in 2014 compared to 2013. The overall increase was primarily due to increased employee compensation-related costs of \$24.4 million, increased marketing program costs of \$6.8 million, and increased travel expenses of \$1.8 million. The 2014 increase in employee compensation-related costs, mainly consisting of salaries, sales commissions, and share-based compensation expense, was driven by the substantial increase in our sales force, share-based compensation expense related to the Performance Awards described above, and \$4.1 million in additional share-based compensation expense related to the accelerated vesting of certain stock options. The 2014 increase in marketing program costs was primarily driven by increases in online lead generation marketing programs to drive the adoption of our platform. Additionally, allocated shared costs increased \$5.3 million.

General and Administrative Expenses

	Year Ended December 31,			2012	2013
	2012	2013	2014	to 2013 % Change	to 2014 % Change
	(In thousands, except percentages)				
General and administrative	\$ 11,558	\$ 16,437	\$ 32,869	42%	100%

General and administrative expenses increased \$4.9 million, or 42%, in 2013 compared to 2012. The increase was primarily due to an increase in employee compensation-related costs of \$7.1 million associated with our substantial increase in headcount and an increase of \$1.6 million in professional and outside services costs, comprised primarily of fees related to legal and accounting services. In addition, in May 2013, we recorded \$1.7 million in share-based compensation expense related to the

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accelerated vesting of certain stock options. The 2013 increase was partially offset by the \$3.7 million charge recorded in connection with the 2012 tender offer described above.

General and administrative expenses increased \$16.4 million, or 100%, in 2014 compared to 2013. The increase was primarily due to an increase in employee compensation-related costs of \$10.4 million and an increase in professional and outside services costs of \$2.8 million. The increase in employee compensation-related costs was due to a substantial increase in headcount and share-based compensation expense related to the Performance Awards described above, partially offset by \$1.7 million in share-based compensation expense recorded in 2013 related to the accelerated vesting of certain stock options. The increase in professional and outside services costs was driven by increased level of business activities and increased costs of being a public company. Additionally, allocated shared costs increased \$2.0 million.

Quarterly Results of Operations

The following unaudited quarterly results of operations data for each of the eight quarters in the two-year period ended December 31, 2014 have been prepared on a basis consistent with our audited consolidated annual financial statements and include, in management's opinion, all normal recurring adjustments necessary for the fair presentation of the results of operations data for these periods, in accordance with generally accepted accounting principles in the United States. The following quarterly financial data should be read in conjunction with our consolidated financial statements and the related notes included elsewhere in this prospectus. The results of historical periods are not necessarily indicative of the results of operations for any future period.

	Three Months Ended							
	Mar 31,	Jun 30,	Sep 30,	Dec 31,	Mar 31,	Jun 30,	Sep 30,	Dec 31,
	2013	2013	2013	2013	2014	2014	2014	2014
	(In thousands)							
Consolidated Statement of Operations Data:								
Revenue	\$ 13,911	\$ 16,396	\$ 19,237	\$ 22,501	\$ 25,092	\$ 29,506	\$ 33,910	\$ 38,541
Cost of revenue ⁽¹⁾	4,870	5,681	6,327	7,653	8,995	11,731	11,684	13,637
Gross profit	9,041	10,715	12,910	14,848	16,097	17,775	22,226	24,904
Operating expenses ⁽¹⁾ :								
Research and development	3,349	3,528	3,860	4,551	5,178	10,499	9,550	11,176
Sales and marketing	7,995	8,208	10,015	11,404	14,287	20,339	21,548	21,701
General and administrative	2,958	5,140	3,646	4,693	6,384	8,315	8,940	9,230
Total operating expenses	14,302	16,876	17,521	20,648	25,849	39,153	40,038	42,107
Operating loss	(5,261)	(6,161)	(4,611)	(5,800)	(9,752)	(21,378)	(17,812)	(17,203)
Other expense, net	(77)	(133)	(102)	(205)	(458)	(450)	(343)	(282)
Loss before provision for (benefit from) income	(5,338)	(6,294)	(4,713)	(6,005)	(10,210)	(21,828)	(18,155)	(17,485)

taxes

Provision for (benefit from) income taxes	20	58	42	101	49	(85)	(236)	9
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Net loss	\$ (5,358)	\$ (6,352)	\$ (4,755)	\$ (6,106)	\$ (10,259)	\$ (21,743)	\$ (17,919)	\$ (17,494)
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(1) Share-based compensation expense was allocated as follows:

	Three Months Ended							
	Mar 31, 2013	Jun 30, 2013	Sep 30, 2013	Dec 31, 2013	Mar 31, 2014	Jun 30, 2014	Sep 30, 2014	Dec 31, 2014
	(In thousands)							
Cost of revenue	\$ 39	\$ 61	\$ 77	\$ 77	\$ 90	\$ 1,010	\$ 591	\$ 773
Research and development	71	155	196	213	310	4,168	3,052	3,388
Sales and marketing	159	229	338	484	490	3,268	4,877	2,045
General and administrative	133	2,022	264	336	934	2,537	2,298	2,308

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	Three Months Ended							
	Mar 31, 2013	Jun 30, 2013	Sep 30, 2013	Dec 31, 2013	Mar 31, 2014	Jun 30, 2014	Sep 30, 2014	Dec 31, 2014
(As a percentage of revenue)								
Consolidated Statement of Operations Data:								
Revenue	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Cost of revenue ⁽¹⁾	35.0	34.6	32.9	34.0	35.8	39.8	34.5	35.4
Gross profit	65.0	65.4	67.1	66.0	64.2	60.2	65.5	64.6
Operating expenses ⁽¹⁾ :								
Research and development	24.1	21.5	20.1	20.2	20.6	35.6	28.2	29.0
Sales and marketing	57.5	50.1	52.1	50.7	56.9	68.9	63.5	56.3
General and administrative	21.3	31.3	19.0	20.9	25.4	28.2	26.4	23.9
Total operating expenses	102.8	102.9	91.1	91.8	103.0	132.7	118.1	109.3
Operating loss	(37.8)	(37.6)	(24.0)	(25.8)	(38.9)	(72.5)	(52.5)	(44.6)
Other expense, net	(0.6)	(0.8)	(0.5)	(0.9)	(1.8)	(1.5)	(1.0)	(0.7)
Loss before provision for (benefit from) income taxes	(38.4)	(38.4)	(24.5)	(26.7)	(40.7)	(74.0)	(53.5)	(45.4)
Provision for (benefit from) income taxes	0.1	0.4	0.2	0.4	0.2	(0.3)	(0.7)	0.0
Net loss	(38.5)%	(38.7)%	(24.7)%	(27.1)%	(40.9)%	(73.7)%	(52.8)%	(45.4)%

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

	Three Months Ended							
	Mar 31, 2013	Jun 30, 2013	Sep 30, 2013	Dec 31, 2013	Mar 31, 2014	Jun 30, 2014	Sep 30, 2014	Dec 31, 2014
(As a percentage of revenue)								
Cost of revenue	0.3%	0.4%	0.4%	0.3%	0.4%	3.4%	1.7%	2.0%
Research and development	0.5	0.9	1.0	0.9	1.2	14.1	9.0	8.8
Sales and marketing	1.1	1.4	1.8	2.2	2.0	11.1	14.4	5.3
General and administrative	1.0	12.3	1.4	1.5	3.7	8.6	6.8	6.0

Quarterly Trends in Revenue and Cost of Revenue

Our quarterly revenue increased sequentially for each period presented, primarily due to sales of new subscriptions to our platform and net expansion by our existing customers. We cannot assure you that this pattern of sequential growth in revenue will continue. In future periods, as our rate of revenue growth declines, seasonality in our revenue may become more apparent.

Our gross margin in the first quarter of any fiscal year is negatively impacted relative to the preceding fourth quarter due to the fewer number of days in the first quarter over which we record subscription revenue as compared to the preceding fourth quarter and the fact that certain expenses in our cost of revenue are not sensitive to the number of days in the quarter.

Quarterly Trends in Operating Expenses

Our quarterly operating expenses increased sequentially for each period presented, primarily due to increased compensation-related costs related to an increase in headcount in connection with the expansion of our business. In the three months ended June 30, 2014, we recorded share-based compensation expense of \$6.1 million related to the Performance Awards. Of the total share-based compensation expense, we recorded \$0.6 million in cost of revenue, \$3.2 million in research and development, \$1.3 million in sales and marketing, and \$1.0 million in general and administrative expenses, respectively. In addition, in the three months ended June 30, 2013 and September 30, 2014, we recorded \$1.7 million and \$2.8 million in share-based compensation expense as a

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component of general and administrative and sales and marketing expenses, respectively, related to the accelerated vesting of certain stock awards.

Credit Facility

We have a credit facility with Silicon Valley Bank consisting of a \$20.0 million revolving line of credit and a \$10.0 million equipment line of credit. As of December 31, 2013, the outstanding balance under the revolving line of credit was \$20.0 million. On June 9, 2014, we repaid all outstanding principal and accrued interest under the revolving line of credit and as of December 31, 2014 there was no outstanding balance. As of December 31, 2013 and December 31, 2014, the outstanding balance under the equipment line of credit was \$3.8 million and \$7.0 million, respectively.

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

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

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

Liquidity and Capital Resources

As of December 31, 2014, our principal sources of liquidity were cash, cash equivalents and marketable securities totaling \$131.7 million, which were held for working capital purposes, as well as the available balance of our credit facility. Our cash equivalents and marketable securities are comprised of corporate bonds, money market funds, asset backed securities, commercial paper, and U.S. treasury securities.

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The following table summarizes our cash flows for the periods indicated:

	Year Ended December 31,		
	2012	2013	2014
	(In thousands)		
Cash provided by (used in) operating activities	\$ (5,096)	\$ 4,005	\$ 2,090
Cash used in investing activities	(7,119)	(24,186)	(71,297)
Cash provided by financing activities	46,705	25,216	95,768

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

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

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

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

Operating Activities

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

Net cash used in operating activities in 2012 was \$5.1 million, reflecting our net loss of \$24.4 million, adjusted by non-cash charges including share-based compensation expense of

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\$9.6 million and depreciation and amortization of \$2.5 million, and changes in our working capital. The changes in our working capital were primarily attributable to an increase in deferred revenue of \$7.7 million due to the growth of our subscription services, an increase in accrued compensation liabilities of \$1.6 million, primarily due to increased headcount, and an increase in accounts payable and accrued liabilities of \$1.1 million due to increased accrual for taxes and timing of payments. These sources of cash flow were partially offset by an increase in prepaid expenses of \$1.6 million primarily due to retention-related compensation, which were amortized as compensation expense over the required service period and an increase in accounts receivable of \$1.4 million due to higher customer billings related to the increase in subscription services during the period.

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

Net cash provided by operating activities in 2014 was \$2.1 million, reflecting our net loss of \$67.4 million, adjusted by non-cash charges including share-based compensation expense of \$32.1 million, depreciation and amortization of \$11.5 million, and changes in our working capital. The changes in our working capital were primarily attributable to an increase in deferred revenue of \$22.4 million due to the growth of our subscription services, an increase in accrued compensation liabilities of \$5.8 million primarily due to a significant increase in headcount and timing of payments, an increase in other assets and liabilities of \$1.7 million due to increased deferred rent, and an increase in accounts payable and accrued liabilities of \$1.3 million due to timing of payments and a higher level of expenses consistent with the overall growth of our business. These sources of cash flow were partially offset by an increase in accounts receivable of \$3.8 million due to higher customer billings related to the increase in subscription services during the period and an increase in prepaid expenses and other current assets of \$1.4 million primarily due to increases in prepaid subscriptions of business software.

Investing Activities

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

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

Net cash used in investing activities in 2014 of \$71.3 million was primarily attributable to purchases of marketable securities of \$54.3 million, purchases of property and equipment of \$21.7 million primarily associated with leasehold improvements related to our new offices and hosting

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equipment, capitalized internal-use software costs of \$8.0 million associated with the development of additional features and functionality of our platform, and payments of \$1.9 million for the acquisition of Zopim, net of cash acquired. The use of cash in investing activities was partially offset by the sale and maturities of marketable securities of \$14.5 million.

Financing Activities

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

During 2013, cash provided by financing activities of \$25.2 million was primarily attributable to proceeds from borrowings under our credit facility of \$23.8 million and proceeds from exercise of stock options of \$1.8 million, partially offset by principal payments on capital lease obligations of \$0.3 million.

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

Contractual Obligations and Other Commitments

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

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

Off-Balance Sheet Arrangements

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

Quantitative and Qualitative Disclosures about Market Risk

Foreign Currency Exchange Risk

We conduct transactions, particularly intercompany transactions, in foreign currencies, primarily the British Pound Sterling, Euro, Australian Dollar, Danish Krone, Singapore Dollar, Japanese Yen,

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

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

Interest Rate Sensitivity

We had cash, cash equivalents, and marketable securities totaling \$131.7 million at December 31, 2014, of which \$72.8 million was invested in corporate bonds, money market funds, asset-backed securities, commercial paper, and U.S. treasury securities. The cash and cash equivalents are held for working capital purposes. Our investments in marketable securities are made for capital preservation purposes. We do not enter into investments for trading or speculative purposes.

Our cash equivalents and our portfolio of marketable securities are subject to market risk due to changes in interest rates. Fixed rate securities may have their market value adversely affected due to a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fluctuate due to changes in interest rates or we may suffer losses in principal if we are forced to sell securities that decline in market value due to changes in interest rates. However because we classify our debt securities as available for sale, no gains or losses are recognized due to changes in interest rates unless such securities are sold prior to maturity or declines in fair value are determined to be other-than-temporary.

As of December 31, 2014, we do not believe that an increase or decrease in interest rates of ten percent (10%) would have a material effect on the value of our cash equivalents and portfolio of marketable securities. Fluctuations in the value of our cash equivalents and portfolio of marketable securities caused by a change in interest rates (gains or losses on the carrying value) are recorded in other comprehensive income, and are realized only if we sell the underlying securities prior to maturity.

Critical Accounting Policies and Estimates

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

Revenue Recognition

We generate substantially all of our revenue from subscription services, which are comprised of subscription fees from customer accounts on our customer service platform and, to a lesser extent, live

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chat software. Arrangements with customers do not provide the customer with the right to take possession of the software supporting our customer service platform or live chat software at any time, and are therefore accounted for as service contracts. Subscription service arrangements are generally non-cancelable and do not provide for refunds to customers in the event of cancellations or any other right of return. We record revenue net of sales or excise taxes.

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

There is persuasive evidence of an arrangement;

The service has been or is being provided to the customer;

The collection of the fees is reasonably assured; and

The amount of fees to be paid by the customer is fixed or determinable.

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

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

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

Capitalized Internal-Use Software Costs

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

Capitalized internal-use software is amortized on a straight-line basis over its estimated useful life and recorded in cost of revenue within the accompanying consolidated statements of operations. The weighted-average useful life of our capitalized internal-use software was 3.2 years as of December 31, 2014. We evaluate the useful lives of these assets and test for impairment whenever events or changes in circumstances occur that could impact the recoverability of these assets. There were no impairments to internal-use software during the years ended December 31, 2012, 2013 and 2014.

Business Combination and Valuation of Goodwill and Purchased Intangible Assets

When we acquire a business, we allocate the purchase price to the net tangible and identifiable intangible assets acquired. Any residual purchase price is recorded as goodwill. The allocation of the purchase price requires management to make significant estimates in determining the fair values of assets acquired and liabilities assumed, especially with respect to intangible assets. These estimates

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can include, but are not limited to, the cash flows that an asset is expected to generate in the future, the appropriate weighted-average cost of capital, and the cost savings expected to be derived from acquiring an asset. These estimates are inherently uncertain and unpredictable.

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

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

Share-Based Compensation

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

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

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

These assumptions are estimated as follows:

Fair Value of Common Stock. Prior to our IPO in May 2014, our board of directors, with input from management, exercised significant judgment and considered numerous objective and subjective factors to

determine the fair value of our common stock as of the date of each option

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grant. These factors included, but were not limited to: (A) contemporaneous valuations performed by unrelated third-party specialists, (B) rights, preferences, and privileges of our redeemable convertible preferred stock relative to those of our common stock, (C) actual operating and financial performance, (D) relevant precedent transactions involving our capital stock, (E) likelihood of achieving a liquidity event, such as an initial public offering or a sale of our company given prevailing market conditions and the nature and history of our business, (F) market multiples of comparable companies in our industry, (G) stage of development, (H) industry information such as market size and growth, (I) illiquidity of share-based awards involving securities in a private company, and (J) macroeconomic conditions.

Since our IPO, we have used the market closing price for our common stock as reported on the NYSE.

Expected Term. We determine the expected term based on the average period the stock options are expected to remain outstanding generally calculated as the midpoint of the stock options vesting term and contractual expiration period, as we do not have sufficient historical information to develop reasonable expectations about future exercise patterns and post-vesting employment termination behavior.

Expected Volatility. We determine the price volatility factor based on the historical volatility of publicly traded industry peers. To determine our peer group of companies, we consider public companies in the technology industry and select those that are similar to us in size, stage of life cycle, and financial leverage. We do not rely on implied volatilities of traded options in our industry peers' common stock because the volume of activity is relatively low. We intend to continue to consistently apply this methodology using the same or similar public companies until sufficient historical information regarding the volatility of our own common stock price becomes available, or unless circumstances change such that the identified companies are no longer similar to us, in which case, more suitable companies whose share prices are publicly available would be utilized in the calculation.

Risk-Free Interest Rate. We base the risk-free interest rate used in the Black-Scholes valuation model on the yield available on U.S. Treasury zero-coupon issues with an equivalent remaining term of the stock options for each stock option group.

Dividend Yield. We have not paid and do not anticipate paying any cash dividends in the foreseeable future and, therefore, use an expected dividend yield of zero.

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

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

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

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compensation expense recognized in our financial statements. If a revised forfeiture rate is lower than the previously estimated forfeiture rate, an adjustment is made that will result in an increase to the share-based compensation expense recognized in our financial statements.

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

Recently Issued and Adopted Accounting Pronouncements

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

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

Under the JOBS Act, we meet the definition of an emerging growth company. We have irrevocably elected to opt out of the extended transition period for complying with new or revised accounting standards pursuant to Section 107(b) of the JOBS Act.

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BUSINESS

Overview

Zendesk believes the fundamental relationship between organizations and their customers is changing. As consumers, we have more choices, have access to more information, and are more connected than ever before. We expect to be heard, engaged, and valued by the organizations we interact with. At the same time, organizations are increasingly recognizing the value of these deeper relationships. As a result, a new customer service philosophy is emerging.

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

In March 2014, we completed the acquisition of Zopim, a software development company that provides a SaaS live chat service. Through Zopim, we provide live chat software as a standalone service and as an integrated service with our customer service platform for chat-enabled agents.

Our business model is designed to drive organic growth, leverage positive word-of-mouth, and remove friction from the evaluation and purchasing process. A substantial percentage of our customers find us online and subscribe to our customer service platform directly from our website. Exemplifying the success of our sales and marketing strategy, during the three months ended December 31, 2014, approximately 64% of our qualified sales leads generated online, and approximately 62% of the total qualified sales leads for our customer service platform, came from organic search, customer referrals, and other unpaid sources. Our largest source of qualified sales leads is free trials of our customer service platform commenced by prospects. Our sales team largely focuses on a land and expand strategy, which leverages this grassroots adoption and seeks to expand our footprint within organizations.

As of December 31, 2014, we had approximately 52,500 paid customer accounts for our customer service platform and live chat software in the aggregate. This includes approximately 27,600 customer accounts for paid subscription plans on our customer service platform, excluding our low-cost Starter plan, and approximately 24,900 customer accounts for paid subscription plans of our live chat software. We also offer freemium plans for our customer service platform and live chat software, as well as email collaboration software, that are offered free of charge or at very low cost. As of December 31, 2014, we had more than 98,000 active accounts using these services. Our customers represent organizations across a broad array of sizes, industries, and geographies. They are located in 150 countries and territories and provide service through our customer service platform in over 40 languages.

Our financial performance reflects our significant customer growth and strong customer retention and expansion. For the years ended December 31, 2012, 2013, and 2014, our revenue was \$38.2 million, \$72.0 million, and \$127.0 million, respectively, representing an 88% annual growth rate.

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from 2012 to 2013 and a 76% annual growth rate from 2013 to 2014. For the years ended December 31, 2012, 2013, and 2014 we derived \$15.8 million, or 41%, \$29.6 million, or 41%, and \$54.8 million, or 43%, respectively, of our revenue from customers located outside of the United States.

Industry Background

Customer Relationships Are Changing

The relationship between organizations and their customers is changing rapidly. As consumers, we experience these changes in our everyday lives. Over the last several years, the ways in which people research, purchase from, and communicate with organizations have evolved from a relatively simple set of interactions into a rapidly expanding network of information and communications. The result is people who are better informed about the products and services they buy; have more choices and potentially less loyalty; and can influence many others with their opinions. People have higher expectations about how an organization will relate to them and less patience for organizations that do not meet these expectations. These expectations are not limited to the business-to-consumer relationship. The customer relationship is increasingly found anywhere an organization wants to maintain a connection with a set of individuals, including business-to-business, business-to-employee, government-to-citizen, and non-profit-to-benefactor realms.

Organizations Must Evolve Their Approach to Customer Service

We believe organizations build successful long-term customer relationships as people do elsewhere in life, with transparent communication, an ability to listen to and incorporate feedback, and a genuine interest in providing a satisfying experience. On a logistical level, an organization must learn to communicate consistently and contextually with customers across multiple channels, including email, chat, voice, social media, and other emerging means of communication. They also need to enable customers to resolve their problems when, where, and how they want, whether by interacting with an agent or through self-service. But perhaps more importantly, because people are more knowledgeable and vocal than ever, an organization must approach the customer experience in a more thoughtful way. Successful customer service is no longer just about handling customer complaints and questions. Instead, it requires that organizations understand and interact with customers as people. Organizations must listen to people when they are speaking and engage with them using empathy, personality, and transparency.

The Opportunity to Build Relationships Through Customer Service

The transformation to a customer-driven economy creates tremendous opportunities for organizations of all sizes that make customer service a critical focus of their operations. We believe that many successful organizations today exemplify this new approach. Whether it is an online brand that removes barriers to completing online purchases or a new entrant that innovates an industry's customer communication methods, organizations are discovering that a deep understanding of the customer experience can be the foundation for building highly valuable customer relationships.

Failing to Adapt to This New Landscape Puts Organizations at Risk

While opportunities abound for organizations that recognize and capitalize on the customer-driven economy, the penalties for failing to evolve to this changing landscape can be severe. That is because there is an entirely new level of communication by and among people. While word-of-mouth and user opinions have always been a force in brand marketing, they now exist on a massive scale with much more efficiency and greater impact. Acting as brand advocates or adversaries, individuals can influence peers' opinions and purchasing behavior. Their voices are amplified through popular community-based ways to research products ranging from social networks, including Facebook,

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Twitter, and Google+, to user-generated reviews, including Yelp, TripAdvisor, and Angie's List. Today's customers can communicate happiness or displeasure instantaneously, exerting strong influence on brands.

Organizations that continue with the traditional uncoordinated, uninformed, and reactive approach to customer service risk customer frustration and lost business. In a 2013 survey of approximately 13,000 consumers by Accenture plc, a consulting firm, 74% complained about having to contact an organization's customer support multiple times for an answer and 66% complained about having to repeat the same information to multiple agents or through multiple channels. Furthermore, over 80% of these survey respondents said an organization could have retained their business with more effective customer service such as quick resolution and proactive engagement.

Legacy Customer Support Software Was Built for a Different Era

We believe organizations are increasingly aware of changing customer expectations and are looking for technology to help them address the opportunities and challenges this presents. Various software tools, delivered both on-premise and in the cloud, have attempted to address the difficult nature of customer support for many years. Unfortunately, this legacy customer support software was largely designed to solve discrete service problems and to minimize the cost of support, instead of fostering customer loyalty and successful long-term relationships. This presents challenges for organizations of all sizes.

Legacy customer support software is costly and complex, causing the vast majority of SMBs to rely primarily on tools like email, phones, and spreadsheets. Even larger organizations able to afford customer support software often adopt a piecemeal approach with the goal of minimizing support costs. The result is the inability to support multiple channels or expand to new channels, ultimately leading to customer frustration. This siloed approach reflects a view of support as a necessary burden rather than an opportunity to build customer loyalty.

Legacy customer support software also limits employees' effectiveness in responding to customer inquiries and offers few, if any, analytics, recommendations, or performance benchmarks. Just as the expectations of the consumer have evolved, so too have the expectations of employees. Familiar with consumer web software like Facebook, Twitter, and Gmail, employees desire tools with similar ease-of-use and sophistication. Most enterprise software, particularly customer support software, has not progressed to embrace consumer design tactics including optimized user experience, availability on personal devices, and ease-of-deployment.

New Solutions Are Needed for the Customer-Driven Economy

Due to the emphasis on customer service in the new customer-driven economy, having the right technology is more important than ever and there are few options to effectively address that need. We believe that effective customer service requires a purpose-built platform that embraces the new landscape of omni-channel communication and the empowered and informed customer, and places an emphasis on well-designed experiences.

This is what Zendesk does. This is what Zendesk cares about.

Market Opportunity

We believe a new and expansive market opportunity exists for technology like our customer service platform that helps organizations navigate the new customer-driven economy and harness its power. With its simplicity, flexibility, scalability, and affordability, our customer service platform can be used by organizations of all sizes. Compared to legacy customer support software, our customer service platform coordinates more extensive customer conversations across more channels, informed

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by all prior interactions, and integrated with other business applications through robust open APIs. The well-designed user experience as well as the ability to painlessly start and expand their platform usage appeal to SMBs and large enterprises alike.

We believe, as a result, our market opportunity is a substantially larger and faster growing opportunity than the already sizable legacy customer support software market. According to IDC, in 2013, the worldwide CRM software market comprised \$22.8 billion. Our customer service platform primarily addresses the customer service and contact center segments which comprised a total of \$10.5 billion in 2013 worldwide. In addition, IDC has estimated that between 2012 and 2017, SaaS solutions in the overall CRM applications market will grow over ten times faster than legacy on-premise solutions.

In a 2013 report, IDC estimated that there were approximately 76 million SMBs worldwide. We believe that many of these organizations have not been able to implement or afford legacy customer support software and therefore represent a substantial greenfield market opportunity for our customer service platform.

Legacy Customer Support Software

Legacy customer support software suffers from a number of design and technical limitations that make it particularly inefficient at addressing the new and evolving customer-driven economy.

Cumbersome and Complex. Legacy software was not designed with the employee and, ultimately, the customer experience in mind. Interfaces are overly complex, inflexible, and difficult to learn and use. The result is cumbersome software that adds obstacles between agents and customers rather than removing them. Customers often suffer long wait times, must repeat themselves, and do not receive the help they need while organizations lose valuable opportunities to increase customer loyalty, upsell additional products, and gather customer feedback.

Disconnected. Organizations have often implemented separate inbound and outbound voice response software in their call centers, then added software point solutions for emerging channels, such as email, chat, and social media, that are poorly integrated with existing solutions. Without functionality to seamlessly engage people across channels and departments, use of legacy software results in uncoordinated customer service efforts and frustrated customers. While many customer inquiries potentially require and could definitely benefit from expertise throughout the organization, such as engineering, product, sales and billing, first line of defense agents are the only ones equipped with the software tools to respond. In addition, customer service representatives are often restricted to supporting customers through a single channel even when other channels would be preferred by the customer and less costly for the organization. This leads to agents who are ill-equipped to adequately address customer concerns and results in customer service that is often disorganized, slow, generic, and unhelpful. Moreover, agents and managers have few tools to organize support efforts, track performance, and inform other employees about recent customer questions or concerns.

Expensive. An organization's need for multiple legacy software products to provide multi-channel customer service drives a high total cost of ownership. The required consultants for installation, customization, and training further increase the upfront and ongoing costs. We believe the limited functionality of legacy software and especially basic tools also increases the cost to provide customer service and results in a low

return on investment because employees are less efficient and effective with their time.

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Legacy Architecture. Legacy software is often as difficult to update or upgrade as it was to initially install due to lengthy consultant-led integrations and complex deployment requirements. As a result, organizations often avoid software changes because they are expensive, time consuming, and frequently require retraining agents. Focused on providing customer support on desktop computers, legacy software also has limited or no mobile functionality and is not designed for “bring your own device” environments.

The Zendesk Approach

Zendesk’s mission is to help organizations and their customers build better relationships. Our comprehensive customer service platform is carefully designed for organizations to address the new customer-driven economy, in which customer service is a key business principle. Our intuitive customer service platform facilitates listening to the customer, finding the best possible answer, communicating through the appropriate channel, and sharing the knowledge gained with the whole organization.

Beautifully Simple. We have an overarching philosophy to be beautifully simple. This approach begins with the look and feel of our customer service platform. We take intuitive design elements that people have grown to expect from consumer software and incorporate them into our customer service platform. The complexity of our underlying technology is wrapped in an easy-to-use interface built to simplify the tough work of customer service. However, beautifully simple at Zendesk extends far beyond that. We offer a free trial and a transparent purchase process with numerous self-service options that are suitable for SMBs and enterprise departments as well as assisted options for larger clients. Once purchased, our customer service platform provides fast results due to an easy set-up with a detailed tutorial and we assist organizations with questions or concerns through our product support team, community forum, and other software tools.

Omni-Channel and Contextual. Our customer service platform is built to support customers across a wide variety of integrated channels – email, voice, social media, and websites. We offer live chat as a standalone service and as a means to integrate chat-enabled agents into our customer service platform. With little to no setup, our customer service platform can receive, manage, track, and report on customer interactions regardless of where they occur. This enables employees to listen to and engage with customers through the appropriate channels. In addition, our customer service platform provides important contextual information around customer issues by encouraging employee collaboration and enabling real-time information sharing. Based on our belief that the best customer service involves a whole organization, our customer service platform makes it easy for multiple departments to work together on as well as stay informed about customer interactions.

Affordable. We believe that customer service practices and philosophy affect the bottom line and that by using our customer service platform organizations can successfully manage customer service in a manner that generates a high return on investment. We believe our subscription plans are significantly less expensive and offer greater pricing transparency than many legacy customer support software applications (especially when software updates, ongoing maintenance and consultant fees required for integration, installation, customization, and training are taken into account). Furthermore, our customer service platform is designed to increase productivity by enabling faster responses, customer self-service tools, and automation.

Natively Mobile. Mobile apps were not an afterthought at Zendesk. We have designed our customer service platform to enable great customer service on-the-go. Through native mobile apps, employees can access our customer service platform anywhere with robust product functionality, an elegant interface, and performance analytics. Our help centers are mobile optimized, allowing people to quickly find answers on their own with mobile devices.

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Cloud-Based Architecture. The dynamic cloud-based architecture that powers our customer service platform allows SMBs and large enterprises alike to invest their time and energy in their customers rather than managing their software. This architecture automates frequent software updates and introduction of new features while also allowing our platform to easily scale within organizations. Configurations made with simple tools, including workflow automations and best practice templates, tailor the functionality and design of our customer service platform to an organization's particular needs and keep customer service efforts of any size organized.

Open Platform. Integrations openly exchange information and product functionality between our customer service platform and other applications, leading to better informed customer conversations. Our platform includes over 270 pre-built integrations with CRM, e-commerce, telephony, live chat, and other apps, which are enabled through our app marketplace. Developed with our open APIs, our platform can also be customized, integrated, or expanded upon with private apps. Through Zendesk Embeddables, we enable customers to simply and natively integrate critical functionality directly into their own websites and applications, including optimized integrations for mobile applications.

Proactive Engagement. Our customer service platform is designed to provide customer service on the customer's terms. Organizations are equipped to proactively communicate with customers at the most relevant and critical moments. For example, organizations can automatically trigger workflow to proactively reach out to customers that may signal they have had a bad experience or need particular attention.

Strategic Analytics. Our customer service platform provides analytics that are mission critical for an organization's operations. In all subscription plans for our customer service platform, managers have access to real-time operational efficiency and customer satisfaction analytics at the interaction, agent, and organizational level. We continuously collect anonymized data, through the Zendesk Benchmark, to regularly report relevant comparisons of an organization's metrics relative to its peers based on size, industry, and geographic region. Managers can be informed through our customer service platform on the strengths and weaknesses of their customer service efforts on an hourly basis, as well as provided with recommendations of how to improve performance.

Benefits of the Zendesk Approach

Benefits to Customers. Through our platform, customer service focuses on people, making it convenient for them to seek help. Information is available where and when they would look. Background information does not need to be repeated nor requests endlessly passed from agent to agent. People's needs can even be anticipated and preemptively addressed by organizations proactively reaching out.

Benefits to Employees. By making it easy to connect with customers and provide knowledgeable responses, our customer service platform empowers employees and improves overall job satisfaction. As the look and feel of our interface matches consumer apps, it is easy for them to learn and navigate. Well-designed features, including automated tasks, save employees time and mobile apps facilitate working outside of the office.

Benefits to Organizations. Our customer service platform creates a strong foundation for customer-focused organizations by managing all of their communication across channels and establishing a centralized source of customer information. Organizations benefit from feedback that can be broadly shared to drive continuous improvement guided by performance metrics. Through the use of our customer service platform, we believe organizations can successfully build their brand, influence strong customer advocates, and, ultimately, enhance their financial performance.

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Growth Strategy

Zendesk was founded in 2007, aiming to help organizations build successful long-term relationships with their customers. We strive to continue the work our three founders began when they looked at the state of customer service and said: we can do better. We are focused on the following key areas of growth:

Introducing New Products and Broadening Our Platform Functionality. We are continuously investing in building a customer service platform that elegantly facilitates and improves customer service and ultimately creates successful long-term customer relationships. Significant research and development efforts are currently focused on broadening our existing customer engagement and communication tools. We intend to continue to develop new products and functionality to expand our platform and support that mission. In addition, we may selectively pursue acquisition opportunities of technologies that can broaden the functionality of our platform.

Furthering Our Data-Driven Approach. We believe our platform is unique for empowering a data-driven approach to customer service. For example, we have introduced the Zendesk Benchmark to enable organizations to compare their critical customer service performance metrics with their peers. Through Zendesk Insights, organizations can compute and display advanced analytics based on their raw data. We plan to expand our data analysis and reporting tools.

Maintaining Leadership in SMB Market. Our customer base today includes a large number of SMBs across industries and geographies. Our customer service platform's ease-of-use, fast results, and flexible pricing are well suited for their needs. We will continue to expand sales in existing organizations, target new organizations, and advance our leadership position in the SMB market.

Expanding Our Enterprise Customer Base. Larger enterprises make up an increasing portion of our customer base. As of December 31, 2014, the percentage of our monthly recurring revenue for our customer service platform generated by customers with 100 or more agents on our customer service platform was 24% as compared to 20% as of December 31, 2013. Our enterprise sales strategy is focused on land and expand, in which we sell our customer service platform into a single department or location and grow by adding agents in other departments, product divisions, and geographies. In addition to increasing the number of users, our customers often upgrade to our more expensive and feature rich subscription plans. We expect our recent sales initiatives to increase sales to new larger enterprises as well as increase our penetration in existing customers through expansion and subscription plan upgrades.

Continuing to Increase Our Global Customer Footprint. With customers in 150 countries and territories, we serve a global market. As of December 31, 2012, 2013, and 2014, we generated 41%, 41%, and 43%, respectively, of our revenue outside of the United States. Our international sales efforts will be focused on certain countries outside of the United States, including Brazil, France, Germany, Japan, and the United Kingdom, where we have demonstrated significant organic customer traction or believe represent particularly strategic opportunities.

Broaden Our Integrations and Partnerships. Our customer service platform is deep and extendible, with over 270 applications integrated with our software, and a network of partner and third-party developers building additional applications which integrate with and embed our platform's functionality. We actively seek out third party developers to build applications on our platform and as of February 2015 had over 2,500 registered developers on our platform developer portal. By growing this Zendesk ecosystem, we plan to build on relationships with

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third-party organizations and developers who further extend our customer service platform into new customers and use cases.

Developing Our Brand. We are focused on strengthening our reputation as a differentiated and category-defining company in customer service. Our brand attributes airy, humble, charming, and uncomplicated distinguish us from the traditional attitudes about organizations and the customer relationship. Our marketing emphasizes our customer service platform's ease-of-use and unique aesthetic in a voice that we believe is memorable and fun (especially relative to legacy enterprise software). We currently host user-groups across the country, and regularly create other opportunities and events to bring together the best in the business to discuss and network. We also regularly publish content with advice for organizations of all sizes about becoming more customer-focused and effectively managing customer service. We believe these branding efforts and thought leadership have accelerated our growth to date and will fuel our future growth by driving organic leads.

Customers

As of December 31, 2014, we had approximately 52,500 paid customer accounts for our customer service platform and live chat software in the aggregate. This includes approximately 27,600 customer accounts for paid subscription plans on our customer service platform, excluding our low-cost Starter plan, and approximately 24,900 customer accounts for paid subscription plans of our live chat software.

Our freemium plans include the Starter plan for our customer service platform, our Lite plan for live chat software, and our Zendesk Inbox service for facilitating and simplifying email collaboration on group email aliases. We believe these services provide exposure to our brand and establish a relationship that can facilitate further adoption of our customer service platform and live chat software as organizations grow in size and their service needs grow more complex. As of December 31, 2014, we had more than 98,000 active customer accounts on our freemium plans. A customer account on our freemium plans is considered active based on whether functionality of the service has been utilized within the 90-day period preceding the measurement date.

Our customers represent organizations across a broad array of sizes, industries, and geographies. Our customers are located in 150 countries and territories and provide service through our customer service platform in over 40 languages.

The following is a sample of our current customers across some of the industries we serve. The customers below vary in size of their respective business and the amount of revenue we derive from them.

Business Technology

Acquia
AdRoll
Box
Dropbox

MINDBODY

New Relic
Pivotal
Shopify

Education/Non-Profit

charity: water
Nottingham Trent University

Consumer Technology

Adobe
Groupon

Media/Entertainment

La Presse
GREE International
REA Group

Retail/eCommerce

Slack	JUST EAT	Deckers Brands
Squarespace	OpenTable Pinterest	Gold's Gym
Twilio	Trivago	JackThreads
Zuora	Uber	MOO
		O'Neill
		UncommonGoods
		Zulily

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Recent Customer Case Studies

We believe that the following case studies provide a representative sample of how our customers use our customer service platform and live chat software. These case studies have been approved by the applicable customers.

GREE International

Situation: For GREE International, or GREE, a global mobile social gaming company, an important part of its customer service strategy is keeping gamers playing its chart-topping titles like Modern War, Crime City, and War of Nations even when they need to seek help or have a question. GREE wanted a customer service platform that would keep its gamers engaged, while also being easy to implement, built to scale, and able to meet its customers' demands.

Solutions and benefits: A key reason GREE relies on our customer service platform is the ability to deploy Zendesk Embeddables to build customer service into the core of mobile and online customer experiences. GREE uses Zendesk Embeddables to make it easy for gamers to get support within the mobile game experience so they don't leave the game to look up the answer to a question. Implementing our mobile SDK helps GREE keep its gamers playing and engaged.

JUST EAT

Situation: JUST EAT, a leading international online takeaway ordering service, needed to move toward a centralized customer service platform across the 13 countries where it operates. It wanted to deploy a single customer service system with common processes while enabling its country teams to operate autonomously to serve their local customers. It also needed a modern system that allowed its agents to respond rapidly since time is of the essence when a customer needs help with a takeaway order. As importantly, it needed software that could scale with its rapid growth and be easily implemented and replicated as it expands to new geographies over time.

Solutions and benefits: JUST EAT started using Zendesk in the Netherlands for its 35 agents as an initial test case, and then expanded its use of our customer service platform to new locations after receiving positive feedback from its customer service team. In 2014, it chose Zendesk as its global customer service platform. Working closely with our team, it devised an implementation plan for an organization-wide rollout with specific business rules and processes to match the maturity of its various markets. JUST EAT now uses our customer service platform in the majority of the countries in which it operates and across hundreds of agents. It has begun to integrate our live chat software into its deployment.

Deckers Brands

Situation: Deckers Brands is a global leader in the footwear industry. Listed on the NYSE, the company owns a number of top brands including: the UGG[®], Teva[®], Sanuk[®], and HOKA One[®] brands. The company has a network of over 130-plus concept and outlet retail locations worldwide tied to its UGG[®] brand where Deckers Brands strives to deliver a premium, seamless and innovative omni-channel experience to its customers. As an example, Deckers Brands' Click and Collect program offers customers the opportunity to order online and choose to ship products to one of the brand's physical retail locations for pick-up. As they were evaluating numerous software solutions to drive this program, it was vital to choose a customer service platform that allowed Deckers Brands the ability to deliver consistent and proactive communication throughout the retail process in a scalable, flexible, and affordable manner.

Solutions and benefits: Since launching its Click and Collect customer service program, Deckers Brands has seen an uptick in demand for the service in the United States, the U.K. and

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France across 30 flagship UGG® brand stores. Deckers Brands has been able to customize the way it gets products to its customers in a more efficient and customer-friendly way and deliver on its omni-channel strategy. The Deckers Brands team has been able to use our customer service platform's user-friendly interface from any location without installing additional hardware or software, allowing the company to quickly and easily roll out the in-store service globally. The flexibility of our customer service platform in maintaining granular access controls and workflows, in addition to robust insights and metrics, has allowed Deckers Brands to provide a more effortless, personal, and efficient experience for its customers.

The Zendesk Customer Service Platform

Our customer service platform allows organizations to focus on the customer service experience within an environment designed for ease-of-use and efficiency. We offer a range of subscription plans to meet the needs of SMBs and larger organizations with the appropriate level of advanced features and product support.

Customer Support

Our platform provides organizations with a single customer service interface to manage all their one-on-one customer interactions, no matter where those conversations start or who needs to be involved to resolve them. Our platform facilitates customer service in an efficient way through application of business rules and automations. This allows for both a reduction in ticket backlog and scaling up to accommodate growing organizations with large global audiences. Our platform is currently available in 14 languages for customer service agents. Key features include:

Single Omni-Channel Interface. Our customer service platform pulls in customer questions from email, chat, voice, and social media and brings them into our beautifully simple interface.

Email. Consolidate customer emails from multiple customer accounts into one interface for routing, assignments, and a single system of record for all conversations.

Chat. Communicate live with one on one chat sessions, which allow customers to initiate real-time support from employees through a web interface. All chat conversations are automatically transcribed into a ticket. We offer our live chat software on a standalone basis and provide a seamless integration of this software as the primary means through which we offer chat functionality on our customer service platform.

Voice. Make or receive calls through our customer service platform. Organizations can natively create support phone numbers or use existing telephony systems through our open API. Voicemails are automatically transcribed into a ticket and employees can record key information from calls in tickets.

Social Media. Convert Tweets and Facebook posts into tickets and reply through our customer service platform to keep a record of all conversations in one interface.

Business Rules. Initiate workflows triggered by ticket field changes or time-based conditions. Our customer service platform comes with pre-configured business rules that we recommend as best practices.

Light Agents. Provide visibility on customer interactions to the entire organization by adding non-support employees as light agents. Light agents can make private internal comments within tickets.

Mobile Apps. View and respond to requests through our native agent mobile apps for the iPhone, iPad, Android devices, Windows Phone, BlackBerry, and Kindle Fire. Our channel

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agnostic SaaS architecture ensures the same information and product functionality is available regardless of the device used.

Customer Self-Service Help Center

Our customer service platform helps organizations track and predict common questions and provides a seamless path to answers. This allows customers to help themselves, find what they need, and minimize their frustration. Available in more than 40 languages for end-users, help centers can be formatted with our self-service optimized themes and customized with organization-specific functionality. Key features include:

Knowledge Base. Create a repository of articles, support documents, and how-to-guides that answers customers' most popular questions. Sections within the knowledge base can be restricted to certain groups of customers or internal employees. Moderators can easily manage multi-lingual content in one place.

Community. Provide customers an opportunity to engage with one another along with the organization through the community. Customers can start a discussion, ask a question, or suggest an idea. Posts can be organized by topic and followed by customers.

Customer Portal. Allow customers to view their customer service history, track outstanding requests, and manage community subscriptions through the customer portal.

Customer Engagement

With customer engagement, customer service becomes less about the ticket and more about people. Our customer service platform lets organizations gather customer data and proactively engage with customers based on the insights the data provides. This turns interactions into proactive conversations and makes them more meaningful, personal, and productive. Key features include:

Custom User and Organization Fields. Create custom user and organization fields to provide context for proactive customer service and set customer-centric workflows around these fields.

Customer Lists. Organize customers into lists based on tags and user fields to enable proactive engagement with those customers.

Customer Satisfaction Ratings. Automatically send a customer satisfaction survey after a customer service request is solved to collect feedback.

Net Promoter Score. Send a simple, single question survey to customers to measure willingness to recommend a product or service and enable organizations to easily identify vocal promoters and detractors as well as customers most likely to spread positive or negative sentiment.

Apps and Integrations. Provide full context for customer interactions through third-party apps and integrations that allow our customer service platform to plug into other important sources of customer and employee data, such as third-party applications for CRM, time tracking, bug tracking, and e-commerce.

Leveraging Strategic Analytics

Our customer service platform offers unique tools for organizations to understand their customers and track the efficiency and effectiveness of their customer service. Key features include:

Reporting and Analytics. Track real-time key performance indicators at the customer interaction, agent, or department level through customer service dashboards that are built into our interface. Metrics included cover customer satisfaction, first response time, ticket volume,

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and usage of self-service features. Through Zendesk Insights, organizations with advanced plans can create custom reports and filter data as well as compute and display advanced analytics based on their raw data that is updated as frequently as every hour.

Zendesk Benchmark. Compare customer service performance against similarly-sized organizations in the same industry and geographic region with the Zendesk Benchmark. Aggregating data to create relevant indices, performance metrics are shown on managers' interfaces for real-time feedback and published in a quarterly report on our website.

Zendesk Embeddables

Through Zendesk Embeddables, we make it simple to extend our customer service platform and integrate critical functionality natively into an organization's website or mobile application. Key features include:

Web Widgets. Easily incorporate contact forms, knowledge base search, and our live chat software directly into websites to allow customers to seek and obtain support at the point of interaction with an organization. Our web widgets are optimized for mobile browsing and tuned to customer browser settings to ensure fidelity in language settings.

Mobile SDK. Build support natively and intuitively directly into mobile applications on both the iOS and Android platforms. Using our SDK, native support in applications is highly customizable, allowing organizations to better maintain their brand in the support environment, and highly contextual, enabling organizations to capture and collect information about device and application usage to improve the customer experience.

Zendesk APIs. Tie together our customer support, customer self-service, and customer engagement elements with even more advanced customizations. We construct our own software from the same APIs that we make available, demonstrating our commitment to the Zendesk developer community and up-to-date code.

Subscription Plans Customer Service Platform

We currently offer a number of subscription plans for our customer service platform that vary based on the level of advanced features and dedicated product support. After a free trial, our customers use a credit card or execute a service order to purchase a subscription plan, typically for a monthly or annual subscription term. Our packaging and pricing philosophy is centered in transparency and simplicity, with all information publicly available on our website. Our subscription plans include:

Starter. At a low monthly or annual price per agent, the Starter plan provides access to our customer service platform for a limited number of employees to customer communications gathered through email, chat, voice, social media, and websites, as well as performance analytics comparisons with the Zendesk Benchmark.

Regular. Well-suited for small organizations and enterprise departments, the Regular plan allows employees to engage with customers through more channels, including community forums. Regular plan subscribers receive email-based product support and can further customize our customer service platform and track performance with customer satisfaction metrics and dashboards.

Plus. To upgrade customer service for organizations of all sizes, extra features in the Plus plan include custom analytics through Zendesk Insights, multi-lingual content management, and internal knowledge base for employees. In addition to email, customers on our Plus plan receive product support from our dedicated customer advocates via phone.

Enterprise. As our deployments grow across departments to be the primary customer service software solution, the Enterprise plan incorporates tools to share customer interactions with the whole organization including unlimited light agents. Customers on our Enterprise plan have the

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ability to easily manage customer service for multiple brands of their organization. In addition, we provide 24/7 email and phone support to drive customer success during deployment and ongoing use.

Enterprise Elite. For enterprise organizations with additional product support needs, the Enterprise Elite plan includes specialized premium service with dedicated support, product training, and service level commitments.

Live Chat Software

Through our live chat software we enable organizations to communicate in real-time with their customers through online chat. Our live chat software offers advanced features to capture, analyze, and automate these conversations, enabling organizations to more effectively engage with their customers, including by proactively reaching them before they've indicated a need for support. We offer our live chat software on a standalone basis and also integrate it as a means to provide chat functionality on our customer service platform for chat-enabled agents.

Subscription Plans Live Chat Software

We currently offer three subscription plans for our live chat software that vary based on the level of advanced features provided. As with the subscription plans for our customer service platform, we provide all prospective customers a free trial. Following this free trial, our customers may use a credit card or execute a service order to purchase a subscription plan, typically for a monthly or annual subscription term. Customers that do not purchase a paid subscription plan, or who terminate a paid subscription plan, are defaulted into the Lite plan. Our subscription plans include the following:

Lite. The Lite plan enables organizations of any size to engage their customers using chat at no cost. An organization is permitted a single agent enabled to engage in chat on a non-concurrent basis. Up to 14 days of chat history is maintained.

Basic. The Basic plan allows agents to engage in an unlimited number of concurrent chats, group chat-enabled employees into up to two relevant departments, and deploy up to two triggers to help identify high value visitors and initiate conversations with them. Basic plan subscribers have full access to their chat history and the ability to fully customize their chat window.

Advanced. The Advanced plan enables organizations to group chat-enabled employees into an unlimited number of departments, deploy unlimited triggers, and establish operating schedules where agents are shown as available or not visible automatically. In addition, our Advanced plan offers powerful analytics to enable organizations to track and monitor activity and increase efficiency.

Sales and Marketing

Subscriptions to our customer service platform and live chat software are designed to be easy to purchase. A substantial number of our customers subscribe to our customer service platform or live chat software with limited or no direct interaction with our sales team.

We also deploy a direct sales approach which includes an inside sales team based in three regional hubs: the Americas, EMEA (Europe, Middle East, and Africa), and APAC (Asia-Pacific). This team qualifies and manages prospective and current customers, aiming to initiate, retain, and expand their use of our customer service platform and live chat software over time. Our inside sales team partners with technical sales and product engineers to provide pre-sales technical support and is also responsible for driving renewals of existing contracts.

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We have begun to develop and expand our field sales and marketing teams responsible for discovery, qualification, and account management for larger organizations. We expect to increase penetration into larger organizations through a land and expand strategy whereby we attempt to capitalize on the limited use of our customer service platform and live chat software by a functional or geographic department to expand the use of our solutions throughout other parts of the organization.

We also utilize indirect sales channels, including referral partners and resellers, as well as implementation partners. These channels provide additional sales coverage, particularly in geographic markets where we may have limited presence, as well as implementation services to our customers. Sales from indirect channels have not been significant to date, but we plan to continue to invest in these relationships to help us in certain markets and to complement our direct sales efforts.

Our marketing efforts are focused on generating awareness of our customer service platform and live chat software, creating sales leads, establishing and promoting our brand, and cultivating a community of successful and vocal customers. Based on our belief that the best method to sell our customer service platform and live chat software is to actively use and explore their capabilities, a central focus of the marketing team is to drive and encourage free trials and the successful conversion of trials to paid subscriptions. At any time during this limited-time trial, the prospective customer may elect to subscribe to simply-priced plans by providing their credit card information. We utilize both online and offline marketing initiatives, including search engine and email marketing, display and video advertising, blogs, corporate communications, whitepapers, case studies, user events, and webinars.

As of December 31, 2014, we had 303 employees in our sales and marketing organization. Our sales and marketing expenses were \$22.7 million, \$37.6 million and \$77.9 million for the years ended December 31, 2012, 2013, and 2014, respectively.

Product Support and Professional Services

We strive to exemplify the great customer service that organizations of all sizes can provide with our customer service platform and live chat software by offering multi-channel service from our product support team, a rich self-help knowledge center with detailed product guides, and active community forums for agents, managers, and developers.

We offer different levels of product support for our customer service platform based upon the subscription plans purchased by our customers. Starter plan customers rely exclusively on our knowledge base and community forums for support. Support from our product support team is offered to all other subscribers, with 24/7 email and voice support available for our Enterprise plan subscribers. Customers that subscribe to our Enterprise Elite plan also have dedicated account management and product support teams. Regardless of the plan purchased, our customer service platform provides an intuitive interface, connectivity to our self-help knowledge base and community forums, and step-by-step tutorials to help employees learn, use and deploy our platform effectively.

Along with our global partners, our professional services team assists our customers in implementing more complex deployments of our customer service platform. These services include mapping our customer service platform to new and existing business processes, data migration, and integration with existing systems. Service engagements are typically scoped on a time and materials or project milestone basis and billed separately from the subscription to our customer service platform.

Through Zen U, our training platform, we offer courses to help our customers quickly learn how to effectively use our customer service platform as well as implement customer service best practices. Courses are available online, in-person at events, and, as requested by certain customers, on-site. Zen

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U sessions are typically targeted at specific levels of employee seniority and product experience, such as agent essentials or administrator expert, to more effectively tailor training to intended audiences.

We maintain a separate dedicated product support team for our live chat software. In the future, we intend to integrate the separate dedicated product support team for our live chat software into our support organization.

Technology

Our technology infrastructure is designed to provide an available and scalable multi-tenant cloud-based platform with industry-standard security measures. We utilize industry leading hardware and software components to provide for and enable the rapid growth of our business. We employ virtualization to maximize utilization where appropriate. Maintaining the integrity and security of our technology infrastructure is critical to our business, and as such we leverage industry-standard security and monitoring tools to ensure performance across our network.

The architecture and deployment of our customer service platform are described and guided by the key characteristics below:

Reliability. Our customers are highly dependent on our customer service platform, which is designed to be available 24 hours a day, 365 days a year. Servers and software components are replicated to ensure fault-tolerance and high availability. Customer data is backed up and is stored in remote data centers. We regularly report to customers on platform availability and technical operations matters through our website and social media alerts.

Scalability. Our application infrastructure is highly scalable and regularly processes more than 100 million data driven requests that each require the processing of specific data, on a daily basis.

Security. Our platform hosts a large quantity of customer data. We maintain a comprehensive security program designed to help safeguard the security and integrity of our customers' data, which includes both organizational and technical measures such as perimeter security, industry standard intrusion detection systems, security protocols, authentication of customers and employees prior to accessing our platform, and testing of each released update before deployment. We regularly review, revise, and update our security program. In addition, we regularly obtain third-party security audits and examinations of our technical operations and practices covering data security, including a Statement on Standard Attestation Engagement No. 16 (SSAE16), Service Organization Controls #2 (SOC 2) Type I Attestation.

We originally utilized third-party managed hosting facilities located in the United States exclusively for hosting our customer service platform. Beginning in 2012, we added use of third-party data centers in which we lease space and where we manage our own hosting and network equipment, or self-managed colocation data centers. We currently operate in three such facilities located in Sacramento, California, Ashburn, Virginia, and Dublin, Ireland. We intend to expand our operations in these and other self-managed colocation data centers over time, although in certain markets we may elect to not pursue this self-managed colocation strategy depending on individual market dynamics. Certain of our customers, as well as backup and certain attachment data will continue to be hosted at third-party managed hosting facilities in the United States and Europe for the foreseeable future.

Our self-managed and third-party managed hosting facilities utilized for our customer service platform provide both physical security measures, including year-round manned security, biometric access controls and video surveillance systems, and systems security measures, including firewalls, environmental controls, and redundant power and Internet connectivity. These facilities have SSAE16

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or ISO 27001 attestations or equivalent certifications with respect to service availability and information security management.

Our live chat software was originally hosted in a managed hosting facility in Orlando, Florida with additional ephemeral-data proxy servers operated in managed hosting facilities located in North America, Europe, and Asia. In January 2015, we migrated all accounts to our self-managed colocation facility in Dublin, Ireland for persistent hosting. We intend to discontinue the use of managed hosting facilities for persistent hosting of our live chat software in 2015.

Research and Development

Our research and development organization is responsible for the development, design, and testing of all aspects of our customer service platform and live chat software. We invest heavily in these efforts to continuously improve and innovate. In addition to our hosted software solution, we have developed a multi-functional API that we utilize to build our customer service platform as well as facilitate integrations of our customer service platform with third-party applications.

Our global research and development team is based in San Francisco, California; Copenhagen, Denmark; Melbourne, Australia; Dublin, Ireland; and Singapore. To foster rapid innovation, our team is further apportioned into smaller, agile development teams. Research and development for our live chat software is primarily managed in Singapore.

We deploy new features, functionality, and technologies for our customer service platform through weekly software releases or updates in order to minimize disruption and provide for constant improvement.

To create a roadmap that meets our customers' needs, we emphasize collaboration during the development process. Customers provide input through feedback forums, dialogue with our product support team, and feature utilization. As a result of using our customer service platform internally to support Zendesk customers, we also develop new or improved features based on our employees' feedback.

As of December 31, 2014, we had 238 employees in our research and development organization. Our research and development expenses were \$14.8 million, \$15.3 million and \$36.4 million for the years ended December 31, 2012, 2013, and 2014, respectively.

Competition

There are a number of established and emerging competitors in the broader customer service software market. This market is fragmented, rapidly evolving, and highly competitive, with relatively low barriers to entry in some segments. We consider the principal competitive differentiators in our market to include:

Ease-of-deployment and use;

Enablement of customer communications across channels;

Availability of self-service options;

Data analytics and performance recommendations;

Mobile and multi-device capabilities;

Proactive outreach tools;

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Complete customer profiles;

Customization and integration with third-party applications;

Brand recognition and thought leadership; and

Total cost of ownership for the customer (including software updates, ongoing maintenance, and consultant fees).

While we believe that we successfully compete with respect to these dynamics, given the large number, disparate sizes and varying areas of focus of other customer service software companies with which we compete, we may not always compare favorably with respect to some or all of the foregoing factors.

For small to medium-sized organizations, we often compete with general use computer applications and other tools that organizations have adapted for customer service, including shared accounts for email communication, phone banks for voice communication, and pen and paper, text editors, and spreadsheets for tracking and management. For larger organizations, we compete with custom software systems and large enterprise software vendors, including salesforce.com, Inc., Oracle Corporation, Verint Systems, Inc., and Microsoft Corporation. Additionally, for organizations seeking software to support employee service and other internal use cases, we compete with companies such as ServiceNow, Inc., BMC Software, Inc., Atlassian Pty Ltd, and Hewlett-Packard Company. In addition, we compete with a number of smaller SaaS providers with focused customer service applications, including desk.com (a salesforce.com service), Kayako Helpdesk Pvt. Ltd., Freshdesk, Inc., Brightwurks, Inc. (Help Scout), SupportBee, Inc., and Tenmiles Technologies Pvt. Ltd. (Happy Fox). We also compete with a number of providers of live chat software, including LivePerson, Inc, BoldChat (a LogMeIn, Inc. service), Velaro, Inc., SnapEngage, LLC, Habla, Inc. (Olark), and LiveChat, Inc. Pricing pressures and increased competition generally could result in reduced sales, reduced margins, losses or the failure of our customer service platform and live chat software to achieve or maintain more widespread market acceptance, any of which could harm our business.

In order to maintain and improve our competitive position in the market, we remain focused in our development, operations, and sales and marketing efforts on evolving customer service needs of all organizations.

Intellectual Property

We rely on a combination of patent, trade secret, copyright, and trademark laws, a variety of contractual arrangements, such as license agreements, assignment agreements, confidentiality and non-disclosure agreements, and confidentiality procedures and technical measures to gain rights to and protect the intellectual property used in our business.

We have developed a patent program, and a strategy to identify, apply for, and secure patents for innovative aspects of our platform and technology. We have one issued U.S. patent and three U.S. patent applications pending. We also have four pending patent applications in jurisdictions outside of the United States. We intend to pursue additional patent protection to the extent we believe it would be beneficial and cost-effective.

We actively pursue registration of our trademarks, logos, service marks, and domain names in the United States and in other key jurisdictions. We are the registered holder of a variety of United States and international domain names that include the term Zendesk and similar variations. We use several trademarks for our products and services, including

Zendesk, Zopim, and several logos and images.

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We also rely on certain intellectual property rights that we license from third parties, including under certain open source licenses. Though such third-party technologies may not continue to be available to us on commercially reasonable terms, we believe that alternative technologies would be available to us.

Our policy is to require employees and independent contractors to sign agreements assigning to us any inventions, trade secrets, works of authorship, developments and other processes generated by them on our behalf and agreeing to protect our confidential information, and all of our key employees and contractors have done so. In addition, we generally enter into confidentiality agreements with our vendors and customers. We also control and monitor access to, and distribution of our software, documentation, and other proprietary information.

Culture and Employees

As a company we are highly focused on our customers and their success. To support this focus, we highly value simplicity, agility, sincerity, as well as a sense of humor and humility often absent from enterprises that sell business software. These values guide our communication, work, and company culture and are a cornerstone of the team of employees that we have assembled and seek to develop. We are a global and diverse group of individuals that strive to balance work with play and a focus on big-scale thinking.

We believe strongly in our obligation to participate in and improve the communities where we work and live. We do this through an active program of corporate social responsibility. Since 2011, we have committed to dedicating an amount equivalent to our revenue from subscriptions to our Starter plan to our corporate responsibility efforts, including the financial support of a variety of non-profit organizations. In addition, we have entered into and implemented a series of community benefits agreements, including extensive volunteer efforts, workforce development and training, financial support for critical community programs, and promotion of local arts and culture, with the communities in which our offices are located and our employees live and work.

As of December 31, 2014, we had a total of 806 employees, including 293 employees located outside the United States. Although we have statutory employee representation obligations in certain countries, our U.S. employees are not represented by a labor union. We have not experienced any work stoppages, and we consider our relations with our employees to be good.

Regulatory Considerations

The legal environment of Internet-based businesses is evolving rapidly in the United States and elsewhere. The manner in which existing laws and regulations are applied in this environment, and how they will relate to our business in particular, both in the United States and internationally, is often unclear. For example, we sometimes cannot be certain which laws will be deemed applicable to us given the global nature of our business, including with respect to such topics as data privacy and security, pricing, credit card fraud, advertising, taxation, content regulation, and intellectual property ownership and infringement.

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Our customers, and those with whom they communicate using our customer service platform and live chat software, upload and store customer service and other data onto our platform, generally without any restrictions imposed by us. This presents legal challenges to our business and operations, such as rights of privacy or intellectual property rights related to the content loaded onto our platform. Both in the United States and internationally, we must monitor and comply with a host of legal concerns regarding the data stored and processed on our platform as well as the operation of our business. These laws include, without limitation, the following:

Data Privacy and Security Laws. Data privacy and security with respect to the collection of PII, continues to be the focus of worldwide legislation and regulation. We are subject to data privacy and security regulation by data protection authorities in countries throughout the world, by the U.S. federal government and by the states in which we conduct our business. In recent years, there have been a number of well-publicized data breaches involving the improper use and disclosure of individuals' personal information of individuals. Many governing authorities have responded to these incidents by enacting laws requiring holders of personal information to maintain safeguards and to take certain actions in response to a data breach, such as providing prompt notification of the breach to affected individuals and public officials, or amending existing laws to expand compliance obligations.

In the European Union, where U.S. companies must meet specified privacy and security standards, the Data Protection Directive, and data protection laws of each of the European Member countries require comprehensive information privacy and security protections for consumers with respect to PII collected about them. With respect to our customer service platform, we certify adherence to the U.S. Department of Commerce's Safe Harbor Privacy Principles and comply with the U.S.-EU and U.S.-Swiss Safe Harbor Frameworks as agreed to and set forth by the U.S. Department of Commerce, and the European Union and Switzerland, concerning U.S. companies doing business in Europe, collecting PII from European citizens, and transferring such PII to the United States Under the Safe Harbor Framework. However, it is not clear whether or for how long applicable data protection authorities in the European Union will continue to recognize such certification as a valid method of compliance with restrictions set forth in the Data Protection Directive and data protection legislation of individual member states restricting the transfer of data outside of the European Economic Area. We post on our website our privacy policies and practices concerning the processing, use and disclosure of PII. Our publication of our U.S.-EU Safe Harbor certification, our privacy policy, and other statements we publish that provide promises and assurances about privacy and security can subject us to potential state and federal action if they are found to be deceptive or misrepresentative of our practices. Since our live chat software is provided by Zopim, a company organized under the laws of Singapore, certification to the U.S. Department of Commerce's Safe Harbor Privacy Principles and compliance with the U.S.-EU and U.S.-Swiss Safe Harbor Frameworks with respect to our live chat software is not available (to the extent such safe harbor processes are still in force). As a result, the use of our live chat software by our EU-based customers may impose additional obligations on such customers to obtain consent from data subjects to transfer PII outside of the European Union.

Certain laws and regulations that protect the collection, use and disclosure of particular types of data may hinder our ability to provide services to customers and potential customers subjected to such laws. For example, rules under the Health Insurance Portability and Accountability Act of 1996 governing the collection, use and disclosure of certain health information impose specific data protection obligations on any organization providing services covered organizations. As another example, the Gramm-Leach-Bliley Act of 1999 imposes specific obligations on companies that process certain financial data on behalf of covered entities. We do not currently certify that our customer service platform or live chat software complies with

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these regulations. In order to compete in such highly regulated markets we will have to invest in additional resources, establish processes, and introduce additional measures to satisfy regulatory requirements applicable to companies serving such covered entities.

Copyrights. U.S. and international copyright and trademark laws protect the rights of third parties from infringement of their intellectual property. Our customers and those with whom they communicate on our customer service platform can generally use our customer service platform to upload and present a wide variety of content. We maintain an active copyright infringement policy and respond to takedown requests by third-party intellectual property right owners that might result from content uploaded to our customer service platform. As our business expands to other countries, we must also respond to regional and country-specific intellectual property considerations, including takedown and cease-and-desist notices in foreign languages, and we must build infrastructure to support these processes. The Digital Millennium Copyright Act, or DMCA, also applies to our business. This statute provides relief for claims of circumvention of copyright-protected technologies but includes a safe harbor that is intended to reduce the liability of online service providers for listing or linking to third-party websites or hosting content that infringes copyrights of others. The copyright infringement policies that we have implemented for our customer service platform and live chat software are intended to satisfy the DMCA safe harbor.

Geographic Information

For a description of our revenue and long-lived assets by geographic location, see Note 12 of the Notes to our Consolidated Financial Statements included elsewhere in this prospectus.

Legal Proceedings

From time to time, we may be subject to legal proceedings and claims in the ordinary course of business. We have received, and may in the future continue to receive, claims from third parties asserting, among other things, infringement of their intellectual property rights. Future litigation may be necessary to defend ourselves, our partners and our customers by determining the scope, enforceability, and validity of third-party proprietary rights, or to establish our proprietary rights. The results of any current or future litigation cannot be predicted with certainty, and regardless of the outcome, litigation can have an adverse impact on us because of defense and settlement costs, diversion of management resources, and other factors.

Facilities

Our corporate headquarters are located in San Francisco, California. We operate in San Francisco under two leases for approximately 72,900 and 34,900 square feet of space, respectively. These leases expire in August 2022 and October 2019, respectively.

We also lease office space in Madison, Wisconsin, Denmark, Germany, Japan, the United Kingdom, Ireland, Australia, the Philippines, Singapore, and Brazil. We intend to procure additional space as we add employees and expand geographically. We believe our facilities are adequate and sufficient for our current needs and that, should it be needed, suitable additional or alternative space will be available to accommodate any such expansion of our operations.

We originally utilized third-party managed hosting facilities located in the United States exclusively for hosting our customer service platform. Beginning in 2012, we added use of third-party data centers in which we lease space and

where we manage our own hosting and network equipment,

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or self-managed colocation data centers. We currently operate in three such facilities located in Sacramento, California, Ashburn, Virginia, and Dublin, Ireland. We intend to expand our operations in these and other self-managed colocation data centers over time, although in certain markets we may elect to not pursue this self-managed colocation strategy depending on individual market dynamics. Certain of our customers, as well as backup and certain attachment data will continue to be hosted at third-party managed hosting facilities in the United States and Europe for the foreseeable future.

Our self-managed and third-party managed hosting facilities utilized for our customer service platform provide both physical security measures, including year-round manned security, biometric access controls and video surveillance systems, and systems security measures, including firewalls, environmental controls, and redundant power and Internet connectivity. These facilities have SSAE16 or ISO 27001 attestations or equivalent certifications with respect to service availability and information security management.

Our live chat software was originally hosted in a managed hosting facility in Orlando, Florida with additional ephemeral-data proxy servers operated in managed hosting facilities located in North America, Europe and Asia. In January 2015, we migrated all accounts to our self-managed colocation facility in Dublin, Ireland for persistent hosting. We intend to discontinue the use of managed hosting facilities for persistent hosting of our live chat software in 2015.

Table of Contents**MANAGEMENT****Executive Officers, Directors, and Key Employees**

The following table provides information regarding our executive officers, directors, and key employees as of February 28, 2015:

Name	Age	Position
<i>Executive Officers:</i>		
Mikkel Svane	44	Chair of the Board of Directors and Chief Executive Officer
Alan Black	54	Senior Vice President and Chief Financial Officer
Marcus Bragg	40	Senior Vice President, Worldwide Sales and Customer Success
John Geschke	44	Senior Vice President, General Counsel, and Secretary
Adrian McDermott	46	Senior Vice President, Product Development
Matthew Price	47	Senior Vice President, Marketing
Anne Raimondi	43	Senior Vice President, Operations
<i>Non-Employee Directors:</i>		
Peter Fenton ⁽¹⁾	42	Director
Caryn Marooney ⁽¹⁾	47	Director
Elizabeth Nelson ⁽²⁾	54	Director
Dana Stalder ⁽²⁾⁽³⁾	46	Director
Michelle Wilson ⁽²⁾⁽³⁾	52	Director
Devdutt Yellurkar ⁽¹⁾⁽³⁾⁽⁴⁾	55	Director
<i>Key Employees:</i>		
Alexander Aghassipour	47	Chief Product Officer
Toke Nygaard	41	Chief Creative Officer
Morten Primdahl	41	Chief Technology Officer
Rick Rigoli	52	Executive Vice President

(1) Member of our compensation committee.

(2) Member of our audit committee.

(3) Member of our nominating and corporate governance committee.

(4) Mr. Yellurkar has elected not to stand for reelection upon expiration of his current term, which expires at our 2015 Annual Meeting of Stockholders.

Executive Officers

Mikkel Svane. Mr. Svane co-founded Zendesk and has served as our Chief Executive Officer since August 2007 and as a member of our board of directors since August 2007. He was appointed Chair of our board of directors in January 2014. Prior to founding Zendesk, Mr. Svane founded and served as the Chief Executive Officer of Caput A/S, a software company, and served as a technology consultant. Mr. Svane holds an A.P. in marketing management from Aarhus Kobmandsskole.

We believe that Mr. Svane is qualified to serve as a member of our board of directors because of his operational and historical expertise gained from serving as our Chief Executive Officer. As one of our founders and the longest

serving member of our board of directors, we also value his deep understanding of our business as it has evolved over time.

Alan Black. Mr. Black has served as our Senior Vice President and Chief Financial Officer since November 2011. From February 2005 to November 2011, Mr. Black served as the Chief Executive Officer of Intelliden Inc., a software company (which was acquired by IBM in January 2010). Mr. Black holds a Bachelor of Commerce, and a Graduate Diploma in public accountancy, from McGill University, and is a Fellow at McGill's Dobson Centre for Entrepreneurial Studies.

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Marcus Bragg. Mr. Bragg has served as our Senior Vice President, Worldwide Sales and Customer Success since August 2013. From June 2012 to February 2013, Mr. Bragg served as the Group Vice President, Customer Experience and Customer Relationship Management at Oracle Corporation, an enterprise software company. Mr. Bragg served as Senior Vice President, Global Sales & Client Success from October 2010 to June 2012 and as Vice President and General Manager, Americas, from September 2008 to October 2010 at RightNow Technologies, Inc. a software company.

John Geschke. Mr. Geschke has served as our Senior Vice President since November 2012 and as our General Counsel and Secretary since July 2012. From April 2010 to June 2012, Mr. Geschke served as General Counsel of Norwest Venture Partners, a venture capital firm. From March 1996 to April 1998 and from May 1999 to March 2010, Mr. Geschke practiced law at Cooley LLP, a law firm. Mr. Geschke currently serves on the board of directors of Zulily, Inc., an Internet retailer. Mr. Geschke holds an A.B. from Princeton University with a concentration in the Woodrow Wilson School of Public and International Affairs and a J.D. from Stanford University.

Adrian McDermott. Mr. McDermott has served as our Senior Vice President, Product Development since July 2010. From July 2007 to July 2010, Mr. McDermott served as the Chief Technology Officer of Attributor Corporation, a software company. Mr. McDermott holds a B.Sc. in computer science from De Montfort University.

Matthew Price. Mr. Price has served as our Senior Vice President, Marketing since August 2014 and prior to that Vice President and General Manager, Europe, Middle East and Africa starting May 2011. From January, 2008 to April, 2011 he served as the Chief Marketing Officer of Trous Technologies, Inc., a software company. Mr. Price holds a B.Sc. in Computer Science from the University of Reading.

Anne Raimondi. Ms. Raimondi has served as our Senior Vice President, Operations since July 2014 and prior to that Vice President, People Operations starting August 2013. From November 2012 to August 2013, Ms. Raimondi served as the Chief Revenue Officer at TaskRabbit, Inc., a provider of an online services marketplace. From May 2012 to November 2012, Ms. Raimondi served as the Chief Executive Officer of One Jackson, Inc., an apparel company. From May 2010 to April 2012, Ms. Raimondi served as Vice President, Marketing at SurveyMonkey Inc., a software company. From September 2007 to June 2010, Ms. Raimondi served as the Vice President of Business Talent Group, a consulting company. Ms. Raimondi holds a B.A. in economics and sociology from Stanford University and an M.B.A. from Stanford University.

Each executive officer serves at the discretion of our board of directors and holds office until his or her successor is duly elected and qualified or until his or her earlier resignation or removal. There are no family relationships among any of our directors or executive officers.

Non-Employee Directors

Peter Fenton. Mr. Fenton has served as a member of our Board since July 2009. Since September 2006, Mr. Fenton has served as a General Partner of Benchmark, a venture capital firm. From October 1999 to May 2006, Mr. Fenton served as a Managing Partner at Accel Partners, a venture capital firm. Mr. Fenton currently serves on the boards of directors of Yelp Inc., a local directory and user review service; Twitter, Inc. a social networking service; Hortonworks, Inc., an open-source distribution platform; New Relic, Inc., a software analytics company; and a number of privately-held companies. Mr. Fenton holds a B.A. in philosophy and an M.B.A. from Stanford University.

Mr. Fenton was selected to serve on our board of directors because of his extensive experience in the venture capital industry and his knowledge of technology companies.

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Caryn Marooney. Ms. Marooney has served as a member of our board of directors since January 2014. Since May 2011, Ms. Marooney has served in various roles at Facebook, Inc., a social networking service, currently serving as the company's Vice President of Technology Communications. From June 1997 to March 2011, Ms. Marooney served in various roles, including President and Chief Executive Officer, of The OutCast Agency, a public relations firm. Ms. Marooney holds a B.S. in labor relations from Cornell University.

Ms. Marooney was selected to serve on our board of directors because of her prior executive experience and her experience advising technology companies.

Elizabeth Nelson. Ms. Nelson has served as a member of our board of directors since July 2013. Ms. Nelson currently serves on the boards of Nokia, a mobile technology and telecommunications company, Pandora Media, Inc. and several private companies. From 1996 to 2005, Ms. Nelson served as the Executive Vice President and Chief Financial Officer at Macromedia, Inc., where she also served as a director from January 2005 to December 2005. Ms. Nelson's public company board service includes serving as a director of Ancestry.com, an online family history company, from 2009 to 2012, of SuccessFactors Inc., a provider of human resources solutions, from 2007 to 2012, of Autodesk Inc., a design software company, from 2007 to 2010, of CNET Networks, Inc., an Internet media company, from 2003 to 2008, and of Brightcove Inc., an online video hosting platform, from 2010 to 2014. Ms. Nelson holds a B.S.F.S. in foreign service from Georgetown University and an M.B.A. in finance with distinction from the Wharton School at the University of Pennsylvania.

Ms. Nelson was selected to serve on our board of directors due to her financial, accounting, and operational expertise from prior experience as an executive and director for public and private technology companies.

Dana Stalder. Mr. Stalder has served as a member of our board of directors since November 2010. Mr. Stalder has been a General Partner of Matrix Partners, a venture capital firm, since August 2008. From December 2001 to August 2008, Mr. Stalder served in various executive roles, including Senior Vice President of PayPal Products Sales and Marketing at eBay, Inc., an online marketplace company. Previously, he was the Chief Financial Officer and Vice President of Business Development of Respond.com, Vice President of Finance and Operations at Netscape Communication Corporation and an associate and manager at Ernst & Young LLP. Mr. Stalder currently serves on the boards of directors of QuinStreet, Inc., an online marketing company, and a number of privately-held companies. He holds a B.S. in commerce from Santa Clara University.

Mr. Stalder was selected to serve on our board of directors because of his significant operational experience as an executive and his deep knowledge of finance and financial reporting which is important to our board directors oversight of strategy, operations, risk management, and financial reporting.

Michelle Wilson. Ms. Wilson has served as a member of our board of directors since January 2014. From July 2003 to September 2012, Ms. Wilson served as Senior Vice President, General Counsel and Secretary of Amazon.com, Inc., an Internet retail company. Ms. Wilson holds a B.A. in business administration from the University of Washington and a J.D. from the University of Chicago.

Ms. Wilson was selected to serve on our board of directors because of her significant experience as an executive in the technology industry.

In connection with the expiration of Mr. Yellurkar's current term at our 2015 Annual Meeting of Stockholders, our board of directors nominated Michelle Wilson to stand for election as a Class I director at our 2015 Annual Meeting of Stockholders. Ms. Wilson notified our board of directors of her

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intention to resign as a Class III director at the conclusion of our 2015 Annual Meeting of Stockholders, contingent upon her election as a Class I director at our 2015 Annual Meeting of Stockholders. Ms. Wilson's decision to resign as a Class III director is solely to facilitate her election as a Class I director at our 2015 Annual Meeting of Stockholders and is not a result of any disagreement with us on any matter relating to our operations, policies, or practices. Effective upon the conclusion of our 2015 Annual Meeting of Stockholders and contingent upon Ms. Wilson's election as a Class I director at such meeting, the size of our board of directors will be reduced from seven directors to six directors by eliminating the vacant directorship that will be created by Ms. Wilson's resignation as a Class III director.

Devdutt Yellurkar. Mr. Yellurkar has served on our board of directors since April 2009. Mr. Yellurkar has been with Charles River Ventures, a venture capital firm, since April 2008 and is a General Partner. Prior to Charles River Ventures, Mr. Yellurkar was the co-founder and Chief Executive Officer of Yantra, a software company. Previously, Mr. Yellurkar was Senior Vice President, Sales and Marketing at Infosys, a global technology services company. Mr. Yellurkar currently serves on the board of several private companies. Mr. Yellurkar holds a B.S. in statistics from Fergusson College.

Mr. Yellurkar was selected to serve on our board of directors because of the breadth of knowledge and valuable insights regarding our business that he has gained from his extensive operational and investment experience in the information technology and SaaS industries.

Mr. Yellurkar has elected not to stand for reelection upon the expiration of his current term, which expires at our 2015 Annual Meeting of Stockholders. Mr. Yellurkar's decision not to stand for reelection is not a result of any disagreement with us on any matter relating to our operations, policies, or practices.

Key Employees

Alexander Aghassipour. Mr. Aghassipour co-founded Zendesk and has served as our Chief Product Officer since August 2007. Mr. Aghassipour holds a Bachelors in electrical engineering from Danmarks Ingeniørakademi and a Masters in information technology from the Technical University of Denmark.

Toke Nygaard. Mr. Nygaard has served as our Chief Creative Officer since November 2011. From January 2002 to September 2011, Mr. Nygaard was the Founder and Creative Director at Cuban Council, a digital design company.

Morten Primdahl. Mr. Primdahl co-founded Zendesk and has served as our Chief Technology Officer since August 2007. Mr. Primdahl holds a Bachelors in chemical engineering from the Technical University of Denmark and a Masters, Sci. IT. in computer science and information technology from the IT University of Copenhagen.

Rick Rigoli. Mr. Rigoli has served as our Executive Vice President since November 2011. From March 2009 to November 2011, he served as our Chief Financial Officer. From July 2006 to December 2008, Mr. Rigoli served as Chief Financial Officer of Brix Networks, Inc., a network technology company. Mr. Rigoli has a B.A. in economics and accounting from the College of the Holy Cross.

Code of Business Conduct and Ethics

Our board of directors has adopted a code of business conduct and ethics that applies to all of our employees, officers and directors, including our Chief Executive Officer, Chief Financial Officer, and other executive and senior financial officers. The full text of our code of business conduct and

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ethics is posted on the investor relations page on our website. We intend to disclose any amendments to our code of business conduct and ethics, or waivers of its requirements, on our website or in filings under the Exchange Act, as required by the applicable rules and exchange requirements.

Board of Directors

Our business and affairs are managed under the direction of our board of directors. The number of directors is fixed by our board of directors, subject to the terms of our certificate of incorporation and bylaws. Our board of directors consists of seven directors, six of whom qualify as independent under the listing standards of the NYSE.

In accordance with our certificate of incorporation and our bylaws, our board of directors are divided into three classes with staggered three-year terms. Only one class of directors is elected at each annual meeting of our stockholders, with the other classes continuing for the remainder of their respective three-year terms. Our directors are divided among the three classes as follows:

the Class I directors are Ms. Marooney and Mr. Yellurkar, and their terms expire at the annual meeting of stockholders to be held in 2015;

the Class II directors are Messrs. Fenton and Stalder, and their terms expire at the annual meeting of stockholders to be held in 2016; and

the Class III directors are Ms. Nelson, Mr. Svane, and Ms. Wilson, and, except as described below, their terms expire at the annual meeting of stockholders to be held in 2017.

Devdutt Yellurkar, a current Class I director, has elected not to stand for reelection upon the expiration of his current term, which expires at our 2015 Annual Meeting of Stockholders. Mr. Yellurkar's decision not to stand for reelection is not a result of any disagreement with us on any matter relating to our operations, policies, or practices. In connection with the expiration of Mr. Yellurkar's current term at our 2015 Annual Meeting of Stockholders, the board of directors nominated Michelle Wilson to stand for election as a Class I director at our 2015 Annual Meeting of Stockholders. Ms. Wilson notified our board of directors of her intention to resign as a Class III director at the conclusion of our 2015 Annual Meeting of Stockholders, contingent upon her election as a Class I director at our 2015 Annual Meeting of Stockholders. Ms. Wilson's decision to resign as a Class III director is solely to facilitate her election as a Class I director at our 2015 Annual Meeting of Stockholders and is not a result of any disagreement with us on any matter relating to our operations, policies, or practices. Effective upon the conclusion of our 2015 Annual Meeting of Stockholders and contingent upon Ms. Wilson's election as a Class I director at such meeting, the size of the board of directors will be reduced from seven directors to six directors by eliminating the vacant directorship that will be created by Ms. Wilson's resignation as a Class III director.

This classification of our board of directors may have the effect of delaying or preventing changes in control of our company.

Originally, Devdutt Yellurkar served on our board of directors as designee of entities affiliated with Charles River Ventures, Peter Fenton served on our board of directors as designee of Benchmark Capital Partners VI, LP, and Dana Stalder served on our board of directors as designee of Matrix IX, L.P., in each case pursuant to the provisions of a voting agreement, among us and certain of our stockholders. The voting agreement terminated upon the completion of

our IPO. For additional information, see Certain Relationships and Related Party Transactions Voting Agreement.

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Director Independence

Our board of directors has undertaken a review of the independence of each director. Based on information provided by each director concerning his or her background, employment, and affiliations, our board of directors has determined that Mmes. Marooney, Nelson, and Wilson and Messrs. Fenton, Stalder, and Yellurkar do not have a relationship that would interfere with the exercise of independent judgment in carrying out the responsibilities of a director and that each of these directors is independent as that term is defined under the applicable rules and regulations of the SEC, and the listing standards of the NYSE. In making these determinations, our board of directors considered the current and prior relationships that each non-employee director has with our company and all other facts and circumstances our board of directors deemed relevant in determining their independence, including the beneficial ownership of our capital stock by each non-employee director, and the transactions involving them described in the section titled Certain Relationships and Related Party Transactions.

Lead Independent Director

Our board of directors has appointed Ms. Nelson to serve as our lead independent director. As lead independent director, Ms. Nelson will preside over periodic meetings of our independent directors, serve as a liaison between our Chair of the board of directors and the independent directors, and perform such additional duties as our board of directors may otherwise determine and delegate.

Committees of the Board of Directors

Our board of directors established an audit committee, a compensation committee, and a nominating and corporate governance committee. The composition and responsibilities of each of the committees of our board of directors is described below. Members will serve on these committees until their resignation or until as otherwise determined by our board of directors.

Audit Committee

Our audit committee consists of Mmes. Nelson and Wilson and Mr. Stalder, with Ms. Nelson serving as Chair. The composition of our audit committee meets the requirements for independence under current listing standards and SEC rules and regulations. Each member of our audit committee meets the financial literacy requirements of listing standards. Ms. Nelson and Mr. Stalder are each an audit committee financial expert within the meaning of Item 407(d) of Regulation S-K under the Securities Act. Our audit committee, among other things:

selects a qualified firm to serve as the independent registered public accounting firm to audit our financial statements;

helps to ensure the independence and performance of the independent registered public accounting firm;

discusses the scope and results of the audit with the independent registered public accounting firm, and review, with management and the independent registered public accounting firm, our interim and year-end operating results;

develops procedures for employees to submit concerns anonymously about questionable accounting or audit matters;

reviews our policies on risk assessment and risk management;

reviews related party transactions; and

approves all audit and all permissible non-audit services, other than de minimis non-audit services, to be performed by the independent registered public accounting firm.

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Our audit committee operates under a written charter that satisfies the applicable rules of the SEC and the listing standards of the NYSE. In accordance with and pursuant to Section 10A(i)(3) of the Exchange Act, our board of directors has delegated to Ms. Nelson the authority to pre-approve any auditing and permissible non-auditing services to be performed by our registered independent public accounting firm, provided that all such decisions to pre-approve an activity are presented to the full audit committee at its first meeting following any such decision.

Compensation Committee

Our compensation committee consists of Ms. Marooney and Messrs. Fenton and Yellurkar, with Mr. Fenton serving as Chair. Mr. Yellurkar has elected not to stand for reelection as director and member of our compensation committee upon the expiration of his current term, which expires at our 2015 Annual Meeting of Stockholders. The composition of our compensation committee meets the requirements for independence under the listing standards of the NYSE and SEC rules and regulations. Each member of the compensation committee is also a non-employee director, as defined pursuant to Rule 16b-3 promulgated under the Exchange Act, and an outside director, as defined pursuant to Section 162(m) of the Code. The purpose of our compensation committee is to discharge the responsibilities of our board of directors relating to compensation of our executive officers. Our compensation committee, among other things:

reviews, approves and determines, or make recommendations to our board of directors regarding, the compensation of our executive officers;

administers our stock and equity incentive plans;

reviews and approves or makes recommendations to our board of directors regarding incentive compensation and equity plans; and

establishes and reviews general policies relating to compensation and benefits of our employees.

Our compensation committee operates under a written charter that satisfies the applicable rules of the SEC and the listing standards of the NYSE.

Nominating and Corporate Governance Committee

Our nominating and corporate governance committee consists of Ms. Wilson and Messrs. Stalder and Yellurkar, with Ms. Wilson serving as Chair. Mr. Yellurkar has elected not to stand for reelection as director and member of our nominating and corporate governance committee upon the expiration of his current term, which expires at our 2015 Annual Meeting of Stockholders. The composition of our nominating and corporate governance committee meets the requirements for independence under the listing standards of the NYSE and SEC rules and regulations. Our nominating and corporate governance committee, among other things:

identifies, evaluates and selects, or makes recommendations to our board of directors regarding, nominees for election to our board of directors and its committees;

considers and makes recommendations to our board of directors regarding the composition of our board of directors and its committees;

reviews and assesses the adequacy of our corporate governance guidelines and recommend any proposed changes to our board of directors; and

evaluates the performance of our board of directors and of individual directors.

The nominating and corporate governance committee operates under a written charter that satisfies the applicable listing requirements and rules of the NYSE.

Table of Contents**Compensation Committee Interlocks and Insider Participation**

None of our executive officers currently serves, or in the past year has served, as a member of the board of directors or compensation committee of any entity that has one or more executive officers serving on our board of directors or compensation committee.

Peter Fenton and Devdutt Yellurkar, members of our compensation committee, are affiliated with Benchmark Capital Partners VI, L.P. and entities affiliated with Charles River Ventures, respectively. In September 2012, we sold shares of our Series D redeemable convertible preferred stock to Benchmark Capital Partners VI, L.P. and entities affiliated with Charles River Ventures. All purchasers of our Series D redeemable convertible preferred stock, including Benchmark Capital Partners VI, L.P. and entities affiliated with Charles River Ventures, are parties to our investors rights agreement and are entitled to specified registration rights thereunder. In October 2012, certain holders of our capital stock, including Benchmark Capital Partners VI, L.P. and entities affiliated with Charles River Ventures, purchased shares of our capital stock from certain of our stockholders pursuant to a tender offer. We have described each of these transactions in more detail under the section captioned Certain Relationships and Related Party Transactions.

Additionally, certain of our existing stockholders, including entities associated with Benchmark and Charles River Ventures, purchased shares of common stock in our IPO at the initial public offering price.

Non-Employee Director Compensation

Prior to April 2014, we did not pay any cash compensation to our non-employee directors, nor did we have a formal policy regarding equity grants to our non-employee directors. In April 2014, our board of directors adopted a policy for annual cash and equity retainers for our non-employee directors pursuant to which our non-employee directors receive the following annual cash retainers for their service:

	Cash Retainer (\$)
Annual Retainer for Non-Employee Directors	\$ 30,000
Additional Annual Retainer for Audit Committee Chairperson	15,000
Additional Annual Retainer for Compensation Committee Chairperson	10,000
Additional Annual Retainer for Nominating and Corporate Governance Committee Chairperson	10,000
Additional Annual Retainer for Audit Committee Non-Chairperson Members	7,500
Additional Annual Retainer for Compensation Committee Non-Chairperson Members	5,000
Additional Annual Retainer for Nominating and Corporate Governance Committee Non-Chairperson Members	5,000

Our policy provides that on the date of each annual meeting of stockholders, each non-employee continuing director will be granted an annual award of restricted stock units having a fair market value of \$150,000. Our policy also provided a one-time grant upon the closing of our IPO to each non-employee director of restricted stock units having a fair market value of \$150,000 based on the closing trading price upon the closing of our IPO. The award of restricted stock units granted will fully vest on the first anniversary of the grant date, in each case, subject to continued service as a director through the vesting date. In addition, such awards are subject to full accelerated vesting upon the sale of the company.

The following table presents the total compensation for each person who served as a non-employee member of our board of directors during fiscal year 2014. Other than as set forth in the table

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and described more fully below, we did not pay any compensation, reimburse any expense of, make any equity awards or non-equity awards to, or pay any other compensation to any of the other non-employee members of our board of directors in fiscal year 2014. Directors who are also our employees receive no additional compensation for their service as a director. The compensation received by Mr. Svane as an employee of the company is presented in Executive Compensation Summary Compensation Table 2014.

Director Compensation Table 2014

Director Name	Fees Earned or Paid in Cash⁽¹⁾	Option Awards⁽²⁾⁽³⁾	Stock Awards⁽²⁾⁽⁴⁾	Total
Peter Fenton, Dana Stalder, Devdutt Yellurkar	\$	\$	\$	\$
Caryn Marooney ⁽⁵⁾	26,250	857,545 ⁽⁶⁾	149,991 ⁽⁷⁾	1,033,786
Elizabeth Nelson ⁽⁸⁾	33,750		149,991 ⁽⁷⁾	183,741
Michelle Wilson ⁽⁹⁾	35,625	857,545 ⁽⁶⁾	149,991 ⁽⁷⁾	1,043,161

- (1) Messrs. Fenton, Stalder, and Yellurkar agreed to waive their annual cash retainers and restricted stock unit grants for the years ended December 31, 2014 and 2015.
- (2) The amounts reported represent the aggregate grant date fair value of the stock options and stock awards, as applicable, awarded to the director in fiscal 2014, calculated in accordance with FASB ASC Topic 718. Such aggregate grant date fair value does not take into account any estimated forfeitures related to service-vesting conditions. The assumptions used in calculating the grant date fair value of the stock options and stock awards, as applicable reported in this column are set forth in the Notes to our Consolidated Financial Statements included elsewhere in this prospectus. The amounts reported in this column reflect the accounting cost for these stock options and stock awards, as applicable, and do not correspond to the actual economic value that may be received by the directors.
- (3) Each stock option was granted pursuant to our 2009 Stock Option and Grant Plan. Unless otherwise described in the footnotes below, this option vests in 48 equal monthly increments following the date of grant, subject to continued service to us. This option is immediately exercisable and provides for full vesting acceleration in the event of a change in control.
- (4) Each restricted stock unit award was granted pursuant to our 2014 Stock Option and Incentive Plan. Unless specified otherwise, each restricted stock unit award will fully vest on the first anniversary of the grant date, in each case, subject to continued service as a director through the vesting date.
- (5) As of December 31, 2014, Ms. Marooney held options to purchase 162,500 shares of our common stock and 8,849 restricted stock units.
- (6) On January 30, 2014, upon joining the board of directors, each of Mmes. Marooney and Wilson received a stock option to purchase 162,500 shares of our common stock, with an exercise price equal to \$9.16 per share.
- (7) Upon the closing of our IPO, each of Mmes. Marooney, Nelson, and Wilson received a grant of restricted stock units having a value equal to approximately \$150,000.
- (8) As of December 31, 2014, Ms. Nelson held options to purchase 72,169 shares of our common stock, 52,960 shares of restricted stock and 8,849 restricted stock units.
- (9) As of December 31, 2014, Ms. Wilson held 125,261 shares of restricted stock and 8,849 restricted stock units.

Table of Contents**EXECUTIVE COMPENSATION****Overview**

The following discussion contains forward-looking statements that are based on our current plans, considerations, expectations, and determinations regarding future compensation programs. The actual amount and form of compensation and the compensation policies and practices that we adopt in the future may differ materially from currently planned programs as summarized below.

As an emerging growth company, we have opted to comply with the executive compensation disclosure rules applicable to smaller reporting companies, as such term is defined in the rules promulgated under the Securities Act. The compensation provided to our named executive officers for 2014 is detailed in the 2014 Summary Compensation Table and accompanying footnotes and narrative that follows this section.

Our named executive officers in 2014 were:

Mikkel Svane, our Chief Executive Officer, or CEO, and co-founder;

Alan Black, our Senior Vice President and Chief Financial Officer, or CFO;

Matthew Price, our Senior Vice President, Marketing; and

Anne Raimondi, our Senior Vice President, Operations.

2014 Summary Compensation Table

The following table presents summary information regarding the total compensation awarded to, earned by, and paid to each individual who served as our CEO, CFO, and the two most highly-compensated executive officers (other than the CEO) who were serving as executive officers as of December 31, 2014 for services rendered in all capacities to the company for such years. These individuals are our named executive officers for fiscal year 2014.

Name and Principal Position ⁽¹⁾	Year	Salary (\$)	Bonus (\$) ⁽²⁾	Option Awards (\$) ⁽³⁾	Non-Equity Incentive Plan	Total (\$)
					Compensation (\$) ⁽⁴⁾	
Mikkel Svane	2014	285,385	18,750	14,006,605	52,500	14,363,240
<i>Chief Executive Officer</i>	2013	200,000	74,906			274,906
Alan Black	2014	269,885	15,000	814,338	48,125	1,147,348
<i>Senior Vice President and Chief Financial Officer</i>	2013	240,000	59,925	552,160		852,085

Matthew Price	2014	253,692 ⁽⁵⁾	75,158 ⁽⁵⁾⁽⁶⁾	2,796,226	92,101 ⁽⁵⁾	3,217,177
<i>Senior Vice President, Marketing</i>						
Anne Raimondi	2014	243,096	12,500	3,675,710	40,250	3,971,556
<i>Senior Vice President, Operations</i>						

- (1) Matthew Price and Anne Raimondi were not named executive officers for fiscal year 2013.
- (2) The amounts reported represent discretionary bonuses paid to each named executive officer for exemplary company performance.
- (3) The amounts reported represent the aggregate grant date fair value of the stock options awarded to the named executive officer in fiscal 2013 and 2014, as applicable, calculated in accordance with FASB ASC Topic 718. Such aggregate grant date fair value does not take into account any estimated forfeitures related to service-vesting conditions. The assumptions used in calculating the

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grant date fair value of the stock options reported in this column are set forth in the Notes to our Consolidated Financial Statements included elsewhere in this prospectus. The amounts reported in this column reflect the accounting cost for these stock options, and do not correspond to the actual economic value that may be received by the named executive officers upon exercise of the options.

- (4) The amounts reported represent the cash bonuses paid pursuant to (i) our Amended and Restated Executive Incentive Bonus Plan, or the Bonus Plan, for Messrs. Svane and Black and Ms. Raimondi and (ii) the sales commission plan for Mr. Price.
- (5) Such amount has been converted from the British Pound to USD, based on the Internal Revenue Service Yearly Average currency Exchange Rate for 2014, which provides the conversion rate of 0.632 GBP : 1 USD.
- (6) Mr. Price's 2014 bonus includes discretionary cash bonuses in the aggregate amount of \$35,601 and a one-time discretionary cash bonus in connection with his July 2014 promotion to Senior Vice President, Marketing in the amount of \$39,557.

2014 Bonus Payments

Our executive officers, including our named executive officers, received discretionary bonuses in fiscal year 2014 for exemplary company performance.

Other than the determination of Mr. Price's bonuses, which is described below, when determining the amounts of the discretionary bonuses, the board of directors based its decisions partially on the company's achievement of its monthly recurring revenue goals and, except for the discretionary bonuses paid to Mr. Svane, partially on input regarding such executive officer's individual performance from Mr. Svane or the other most senior executive officer to whom the officer reported. The discretionary bonuses paid to Mr. Svane were based on the evaluation of Mr. Svane's individual performance by the board of directors.

Prior to his promotion to Senior Vice President, Marketing in July 2014, Mr. Price's discretionary bonuses were determined by his manager at the time. In connection with his promotion to Senior Vice President, Marketing, our compensation committee granted Mr. Price a one-time discretionary bonus.

In addition to the discretionary bonuses, Mr. Price received commissions pursuant to a sales commission plan and Messrs. Svane and Black and Ms. Raimondi received bonuses under our Bonus Plan for fiscal year 2014.

Amended and Restated Executive Incentive Bonus Plan

In February 2015, our board of directors, upon the recommendation of our compensation committee, adopted the Bonus Plan, which was originally adopted on April 18, 2014, and which governs cash and equity incentive bonuses for certain of our eligible executives, including our named executive officers. The Bonus Plan provides for bonus payments based upon the attainment of performance targets, or the Performance Goals, established by the compensation committee and related to financial and operational measures or objectives with respect to the company, as well as individual performance objectives.

The Performance Goals from which the compensation committee may select include the following: cash flow (including, but not limited to, operating cash flow and free cash flow); revenue; earnings before interest, taxes, depreciation and amortization; net income (loss) (either before or after interest, taxes, depreciation or amortization); changes in the market price of our common stock; economic value-added; acquisitions or strategic transactions; operating income (loss); return on capital, assets, equity, or investment; stockholder returns; return on sales; gross or net profit levels;

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productivity; expense efficiency; margins; operating efficiency; customer satisfaction; working capital; earnings (loss) per share of our common stock; bookings, new bookings, expansion, or renewals; sales or market share; number of customers, number of new customers, or customer references; or operating income or net annual or monthly recurring revenue (any of which may be measured in absolute terms or compared to any incremental increase, measured in terms of growth, compared to another company or companies or to results of a peer group, measured against the market as a whole or as compared to applicable market indices, measured on a pre-tax or post-tax basis or applied to the performance of a business unit, segment, product line, or specific market, or the entire company).

Each executive officer who is selected to participate in the Bonus Plan will have a target bonus opportunity set for each performance period. The bonus formulas will be adopted in each performance period by the compensation committee and communicated to each executive. The Performance Goals will be measured at the end of each performance period after our financial reports have been published or such other appropriate time as the compensation committee determines. If the Performance Goals and individual performance objectives are met, payments will be made as soon as practicable following the end of each performance period. Subject to the rights contained in any agreement between the executive officer and us, an executive officer must be employed by us on the bonus payment date to be eligible to receive a bonus payment. The Bonus Plan also permits the compensation committee to approve additional bonuses to executive officers in its sole discretion and to adjust bonuses (by increasing or decreasing the amount payable) based on an executive officer's attainment of individual performance objectives.

Outstanding Equity Awards at Fiscal 2014 Year-End

The following table summarizes, for each of the named executive officers, the outstanding equity awards held as of December 31, 2014.

Name	Grant Date	Option Awards ⁽¹⁾⁽²⁾⁽³⁾			Stock Awards ⁽²⁾⁽³⁾⁽⁴⁾		
		Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Exercise Price (\$)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested as of December 31, 2014 (#)	Market Value of Shares or Units of Stock that have not Vested as of December 31, 2014 (\$) ⁽⁵⁾
Mikkel Svane	2/13/2014 ⁽⁶⁾	2,150,000		9.52	2/13/2024		
Alan Black	11/9/2011 ⁽⁷⁾⁽⁸⁾					287,500	7,006,375
	5/3/2013 ⁽⁸⁾⁽⁹⁾	87,500		6.24	5/3/2023	14,584	355,412
	2/13/2014 ⁽⁸⁾⁽¹⁰⁾	125,000		9.52	2/13/2024		
Matthew Price	5/19/2011 ⁽¹¹⁾⁽¹²⁾		24,479	0.61	5/19/2021		
	7/18/2012 ⁽¹²⁾⁽¹³⁾		51,667	2.30	7/18/2022		
				9.52	2/13/2024		
				24.89	9/04/2024		
	2/13/2014 ⁽¹²⁾⁽¹⁴⁾	95,840					
		12,499	137,501				

	9/04/2014 ⁽¹²⁾⁽¹⁵⁾				
Anne Raimondi	9/03/2013 ⁽¹⁶⁾⁽¹⁷⁾				
	2/13/2014 ⁽¹⁷⁾⁽¹⁸⁾	190,000		6.58	9/03/2023
		250,000		9.52	2/13/2024
	9/04/2014 ⁽¹⁷⁾⁽¹⁹⁾	12,499	137,501	24.89	9/04/2024

- (1) Each stock option was granted pursuant to our 2009 Stock Option and Grant Plan unless otherwise indicated below. Unless otherwise described in the footnotes below, the stock options are not immediately exercisable. Unless otherwise described in the footnotes below, the shares of common stock subject to such stock options will vest over a four-year period, with 25% of the shares to vest upon completion of one year of service measured from the vesting commencement date, and the balance to vest in 36 successive equal monthly installments.
- (2) In February 2015, we granted options to purchase 232,900, 102,500, 39,100, and 48,200 shares of our common stock under our 2014 Stock Option and Incentive Plan to Messrs. Svane, Black, and Price and Ms. Raimondi, respectively, and 40,900, 18,000, 6,900, and 8,500 restricted stock units under our 2014 Stock Option and Incentive Plan to Messrs. Svane, Black, and Price and Ms. Raimondi, respectively.

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- (3) Unless otherwise described in the footnotes below, the vesting of each equity award on a vesting date is subject to the equity award holder's provision of service through such vesting date.
- (4) Each stock award was granted pursuant to our 2009 Stock Option and Grant Plan, unless otherwise indicated below. Unless otherwise described in the footnotes below, each stock award vests over a four-year period, with 25% of the shares to vest upon completion of one year of service measured from the vesting commencement date, and the balance to vest in 36 successive equal monthly installments thereafter.
- (5) Amounts calculated using the closing market price of a share of the Company's common stock as of December 31, 2014, which was \$24.37.
- (6) This stock option to purchase 2,150,000 shares of our common stock vests in 60 equal monthly installments following the grant date. The stock option is immediately exercisable and vesting will accelerate in full in the event Mr. Svane's employment with us is terminated by us without cause or by Mr. Svane for good reason at any time during the period that ends 12 months following the consummation date of a change of control of the company.
- (7) This restricted stock award for 750,000 shares of our common stock vests over a five-year period, with 20% vested upon completion of one year of service measured from the grant date, and the balance vesting in 48 successive equal monthly installments thereafter.
- (8) The equity award has full vesting acceleration in the event that there is a change in control of our company and Mr. Black does not retain his current position in the combined ongoing company.
- (9) This stock option to purchase 175,000 shares of our common stock vests in 48 equal monthly installments commencing on April 23, 2013. The stock option is immediately exercisable. Mr. Black early exercised the option to purchase 87,500 shares, of which 14,584 shares remain unvested as of December 31, 2014.
- (10) This stock option to purchase 125,000 shares of our common stock vests in 60 equal monthly installments following the grant date, and is immediately exercisable.
- (11) This stock option to purchase 235,000 shares of our common stock vests over a four-year period, with 25% vested upon May 5, 2012, and the balance vesting in 36 successive equal monthly installments thereafter.
- (12) The equity award has vesting acceleration as to 50% of the unvested equity award in the event there is a change in control of our company and Mr. Price is not offered continued employment in the combined ongoing company.
- (13) This stock option to purchase 100,000 shares of our common stock vests over a five-year period, with 20% vested after completion of one year of service measured from the grant date, and the balance vesting in 48 successive equal monthly installments commencing on August 18, 2013.
- (14) This stock option to purchase 115,000 shares of our common stock vests in 60 equal monthly installments following the grant date, and is immediately exercisable.
- (15) This stock option, granted under our 2014 Stock Option and Incentive Plan, to purchase 150,000 shares of our common stock vests in 60 equal monthly installments commencing on August 30, 2014.
- (16) This stock option to purchase 200,000 shares of our common stock vests over a four-year period, with 25% vested upon August 19, 2014, and the balance vesting in 36 successive equal monthly installments thereafter. The stock option is immediately exercisable.
- (17) The equity award has full vesting acceleration in the event that Ms. Raimondi's employment is terminated without cause or resigns for good reason within 12 months following a change of control of the company.
- (18) This stock option to purchase 250,000 shares of our common stock vests in 60 equal monthly installments following February 13, 2014, and is immediately exercisable.
- (19) This stock option, granted under our 2014 Stock Option and Incentive Plan, to purchase 150,000 shares of our common stock vests in 60 equal monthly installments commencing on August 30, 2014.

Executive Employment Arrangements and Potential Payments upon Termination or

Change of Control

Offer Letters and Employment Agreements

Alan Black

On October 28, 2011, we entered into an offer letter with Mr. Black for the position of Chief Financial Officer. The offer letter provides for his at-will employment and sets forth his initial base salary, initial equity award, and eligibility for the company's benefit plans generally.

Matthew Price

On May 9, 2011, we entered into an offer letter, and then subsequently an employment agreement on July 15, 2011, with Mr. Price for the position of Vice President and General Manager of EMEA (Europe, the Middle East, and Africa). He was subsequently promoted and appointed as our Senior Vice President, Marketing on July 30, 2014. The offer letter and employment agreement

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generally provide for his employment in the United Kingdom and set forth his initial base salary, initial equity award, initial bonus target and eligibility for the company's benefit plans in the United Kingdom generally.

Anne Raimondi

On July 1, 2013, we entered into an offer letter with Ms. Raimondi for the position of Vice President, People Ops. She was subsequently promoted and appointed as our Senior Vice President, Operations on July 30, 2014. The offer letter provides for her at-will employment and sets forth her initial base salary, initial equity award, and eligibility for the company's benefit plans generally.

Equity Awards

Mikkel Svane

In the event of a termination of employment by us without cause or by Mr. Svane for good reason (in each case as defined in the equity award agreement) at any time during the period that ends 12 months following a sale event (as defined in the 2009 Stock Option and Grant Plan or the 2014 Stock Option and Incentive Plan, or our 2014 Plan), 100% of the unvested equity subject to the outstanding equity awards of Mr. Svane will be accelerated.

Alan Black

In the event of a sale event (as defined in the 2009 Stock Option and Grant Plan or the 2014 Plan) in which Mr. Black does not retain his current position in the combined ongoing company, 100% of the unvested equity subject to the outstanding equity awards of Mr. Black will be accelerated.

Matthew Price

In the event of a sale event (as defined in the 2009 Stock Option and Grant Plan or the 2014 Plan, as applicable) in which Mr. Price is not offered employment with the combined ongoing company, 50% of the unvested equity subject to the outstanding equity awards of Mr. Price will be accelerated.

Anne Raimondi

In the event of a termination of employment by us without cause or by Ms. Raimondi for good reason (in each case as defined in the offer letter or the equity agreements, as applicable) at any time during the period that ends 12 months following a sale event (as defined in the 2009 or the 2014 Plan, as applicable), 100% of the unvested equity subject to the outstanding equity awards of Ms. Raimondi will be accelerated.

Employee Benefit and Stock Plans

2014 Stock Option and Incentive Plan

Our 2014 Plan, was adopted by our board of directors in February 2014 and approved by our stockholders in April 2014 and became effective immediately prior to our IPO. The 2014 Plan replaced the 2009 Stock Option and Grant Plan and no awards under that plan have been granted following the date of our IPO. The 2014 Plan allows the compensation committee to make equity-based incentive awards to our officers, employees, directors and other key persons (including consultants).

We initially reserved 7,500,000 shares of our common stock for the issuance of awards under the 2014 Plan, plus the shares of common stock remaining available for issuance under our 2009 Stock Option and Grant Plan. The 2014 Plan provides that the number of shares reserved and available for issuance under the plan will automatically increase each January 1, beginning on January 1, 2015, by 5% of the outstanding number of shares of our common stock on the immediately preceding December 31 or

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such lesser number of shares as determined by our compensation committee. This number is subject to adjustment in the event of a stock split, stock dividend or other change in our capitalization.

As of December 31, 2014, options to purchase 820,000 shares of our common stock remained outstanding under our 2014 Plan at a weighted-average exercise price of approximately \$22.98 per share and restricted stock units covering 1,095,281 shares of our common stock remained outstanding under our 2014 Plan at a weighted-average grant date fair value of approximately \$19.30 per share.

The shares we issue under the 2014 Plan will be authorized but unissued shares or shares that we reacquire. The shares of common stock underlying any awards that are forfeited, cancelled, held back upon exercise or settlement of an award to satisfy the exercise price or tax withholding, reacquired by us prior to vesting, satisfied without the issuance of stock, expire or are otherwise terminated (other than by exercise) under the 2014 Plan and the 2009 Stock Option and Grant Plan will be added back to the shares of common stock available for issuance under the 2014 Plan.

Stock options and stock appreciation rights with respect to no more than 5,000,000 shares of common stock may be granted to any one individual in any one calendar year. The maximum number of shares that may be issued as incentive stock options in any one calendar year period may not exceed 7,500,000 cumulatively increased on January 1, 2016 and on each January 1 thereafter by the lesser of 5% of the number of outstanding shares as of the immediately preceding December 31, or 7,500,000 shares.

The 2014 Plan is administered by our compensation committee. Our compensation committee has full power to select, from among the individuals eligible for awards, the individuals to whom awards will be granted, to make any combination of awards to participants, and to determine the specific terms and conditions of each award, subject to the provisions of the 2014 Plan. Persons eligible to participate in the 2014 Plan will be those full or part-time officers, employees, non-employee directors and other key persons (including consultants) as selected from time to time by our compensation committee in its discretion.

The 2014 Plan permits the granting of both options to purchase common stock intended to qualify as incentive stock options under Section 422 of the Code and options that do not so qualify. The option exercise price of each option will be determined by our compensation committee but may not be less than 100% of the fair market value of our common stock on the date of grant. The term of each option will be fixed by our compensation committee and may not exceed ten years from the date of grant. Our compensation committee will determine at what time or times each option may be exercised.

Our compensation committee may award stock appreciation rights subject to such conditions and restrictions as it may determine. Stock appreciation rights entitle the recipient to shares of common stock, or cash, equal to the value of the appreciation in our stock price over the exercise price. The exercise price may not be less than 100% of the fair market value of our common stock on the date of grant. The term of each stock appreciation right will be fixed by our compensation committee and may not exceed ten years from the date of grant. Our compensation committee will determine at what time or times each stock appreciation right may be exercised.

Our compensation committee may award restricted shares of common stock and restricted stock units to participants subject to such conditions and restrictions as it may determine. These conditions and restrictions may include the achievement of certain Performance Goals and/or continued employment with us through a specified vesting period. Our compensation committee may also grant shares of common stock that are free from any restrictions under the 2014 Plan. Unrestricted stock may be granted to participants in recognition of past services or for other valid consideration and may be issued in lieu of cash compensation due to such participant.

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Our compensation committee may grant performance share awards to participants that entitle the recipient to receive awards of common stock upon the achievement of certain Performance Goals and such other conditions as our compensation committee shall determine. Our compensation committee may grant dividend equivalent rights to participants that entitle the recipient to receive credits for dividends that would be paid if the recipient had held a specified number of shares of common stock.

Our compensation committee may grant cash bonuses under the 2014 Plan to participants, subject to the achievement of certain Performance Goals.

Our compensation committee may grant awards of restricted stock, restricted stock units, performance share awards or cash-based awards under the 2014 Plan that are intended to qualify as performance-based compensation under Section 162(m) of the Code. Such awards will only vest or become payable upon the attainment of Performance Goals that are established by our compensation committee and related to one or more performance criteria. The performance criteria that could be used with respect to any such awards include: total stockholder return, earnings before interest, taxes, depreciation and amortization, net income (loss) (either before or after interest, taxes, depreciation and/or amortization), changes in the market price of our common stock, economic value-added, funds from operations or similar measure, sales or revenue, acquisitions or strategic transactions, operating income (loss), cash flow (including, but not limited to, operating cash flow and free cash flow), return on capital, assets, equity, or investment, return on sales, gross or net profit levels, productivity, expense, margins, operating efficiency, customer satisfaction, working capital, earnings (loss) per share of our common stock, sales or market shares and number of customers, any of which may be measured either in absolute terms or as compared to any incremental increase or as compared to results of a peer group. From and after the time that we become subject to Section 162(m) of the Code, the maximum award that is intended to qualify as performance-based compensation under Section 162(m) of the Code that may be made to certain of our officers during any one calendar year period is 10,000,000 shares of common stock with respect to a share-based award and \$5.0 million with respect to a cash-based award.

The 2014 Plan provides that upon the effectiveness of a sale event, as defined in the 2014 Plan, an acquirer or successor entity may assume, continue or substitute for the outstanding awards under the 2014 Plan. To the extent that awards granted under the 2014 Plan are not assumed or continued or substituted by the successor entity, all unvested awards granted under the 2014 Plan shall terminate. In the event of such termination, individuals holding options and stock appreciation rights will be permitted to exercise such options and stock appreciation rights (to the extent exercisable) prior to the sale event. In addition, in connection with the termination of the 2014 Plan upon a sale event, we may

110.9

56.2

Total
3,679

2,569

1,667

2,629.5

1,669.9

981.1

42

Revenues and Income (Loss) Before Income Taxes (\$ amounts in millions):

	Revenues			Income (loss) before income taxes		
	2013	2012	2011	2013	2012	2011
Traditional Home Building:						
North	\$485.0	\$350.7	\$320.8	\$32.7	\$13.9	\$11.5
Mid-Atlantic	652.9	535.7	465.1	79.8	63.0	48.8
South	641.3	361.8	273.3	67.9	18.9	(25.3)
West	724.4	437.9	309.6	111.3	39.4	(27.1)
Traditional Home Building	2,503.6	1,686.1	1,368.8	291.7	135.2	7.9
City Living	170.7	196.7	107.1	53.3	61.9	39.2
Corporate and other				(77.3)	(84.2)	(76.5)
Total	\$2,674.3	\$1,882.8	\$1,475.9	\$267.7	\$112.9	\$(29.4)

Corporate and other is comprised principally of general corporate expenses such as the offices of the Executive Chairman, Chief Executive Officer and President, and the corporate finance, accounting, audit, tax, human resources, risk management, marketing and legal groups, directly expensed interest, offset, in part, by interest income, income from our ancillary businesses, and income from a number of our unconsolidated entities.

Total Assets (\$ amounts in millions):

	At October 31,	
	2013	2012
Traditional Home Building:		
North	\$963.6	\$757.4
Mid-Atlantic	1,231.4	1,155.7
South	954.0	800.2
West	1,290.4	904.4
Traditional Home Building	4,439.4	3,617.7
City Living	674.3	487.0
Corporate and other	1,713.8	2,076.3
Total	\$6,827.5	\$6,181.0

Corporate and other is comprised principally of cash and cash equivalents, marketable securities, deferred tax assets and the assets of the Company's Gibraltar investments, manufacturing facilities and mortgage subsidiary.

FISCAL 2013 COMPARED TO FISCAL 2012

North

Revenues in fiscal 2013 were higher than those in fiscal 2012 by \$134.3 million, or 38.3%. The increase in revenues was primarily attributable to a 27.2% increase in the number of homes delivered and an increase of 8.7% in the average selling price of the homes delivered. The increase in the number of homes delivered in fiscal 2013, as compared to fiscal 2012, was primarily due to a higher backlog at October 31, 2012, as compared to October 31, 2011. The increase in the average price of homes delivered in fiscal 2013, as compared to fiscal 2012, was primarily attributable to a shift in the number of homes delivered to more expensive areas and/or products and increases in selling prices in fiscal 2013.

The value of net contracts signed in fiscal 2013 was \$697.5 million, a 56.7% increase from the \$445.2 million of net contracts signed during fiscal 2012. This 56.7% increase was primarily due to a 45.8% increase in the number of net contracts signed and a 7.5% increase in the average value of each net contract. The increase in the number of net contracts signed was primarily due to an improvement in home buyer demand in fiscal 2013 as compared to fiscal 2012. The increase in the average sales price of net contracts signed in fiscal 2013, as compared to fiscal 2012, was primarily attributable to a shift in the number of contracts signed to more expensive areas and/or products and increases in selling prices in fiscal 2013.

In fiscal 2013, we reported income before income taxes of \$32.7 million, as compared to \$13.9 million in fiscal 2012. This increase in income was primarily attributable to higher earnings from the increased revenues in fiscal 2013, as compared to fiscal 2012, offset, in part, by higher SG&A. The increase in SG&A was due primarily to increased compensation, sales and marketing costs

Mid-Atlantic

Revenues in fiscal 2013 were higher than those in fiscal 2012 by \$117.2 million, or 21.9%. The increase in revenues was primarily attributable to a 19.6% increase in the number of homes delivered and a 1.9% increase in the average selling price of the homes delivered. The increase in the number of homes delivered in fiscal 2013, as compared to fiscal 2012, was primarily due to a higher backlog at October 31, 2012, as compared to October 31, 2011, primarily in Pennsylvania and Virginia. The increase in the average price of homes delivered in fiscal 2013, as compared to fiscal 2012, was primarily attributable to a shift in the number of homes delivered to more expensive areas and/or products and increases in selling prices in fiscal 2013.

The value of net contracts signed during fiscal 2013 increased by \$225.8 million, or 36.1%, from fiscal 2012. The increase was due to a 26.8% increase in the number of net contracts signed and a 7.3% increase in the average value of each net contract. The increase in the number of net contracts signed was primarily due to an increase in home buyer demand in fiscal 2013, as compared to fiscal 2012. The increase in the average sales price of net contracts signed was primarily due to a shift in the number of contracts signed to more expensive areas and/or products and increases in selling prices in fiscal 2013.

We reported income before income taxes in fiscal 2013 and 2012 of \$79.8 million and \$63.0 million, respectively. The increase in the income before income taxes in fiscal 2013 was primarily due to higher earnings from the increased revenues and lower inventory impairment charges in fiscal 2013, as compared to fiscal 2012, offset, in part, by higher SG&A in fiscal 2013, as compared to fiscal 2012. We recognized inventory impairment charges of \$0.5 million and \$6.0 million in fiscal 2013 and 2012, respectively.

South

Revenues in fiscal 2013 were higher than those in fiscal 2012 by \$279.5 million, or 77.3%. This increase was attributable to a 63.1% increase in the number of homes delivered and a 8.7% increase in the average price of the homes delivered. The increase in the number of homes delivered in fiscal 2013, as compared to fiscal 2012, was primarily due to a higher backlog at October 31, 2012, as compared to October 31, 2011, which was the result of an increase in the number of net contracts signed in fiscal 2012 as compared to fiscal 2011. The increase in the average price of the homes delivered in fiscal 2013, as compared to fiscal 2012, was primarily attributable to a shift in the number of homes delivered to more expensive areas and/or products and increases in selling prices in fiscal 2013. In fiscal 2013, the value of net contracts signed increased by \$249.3 million, or 42.8%, as compared to fiscal 2012. The increase was attributable to increases of 31.6% and 8.5% in the number and average value of net contracts signed, respectively. The increase in the number of net contracts signed in fiscal 2013, as compared to fiscal 2012, was primarily due to increased demand in fiscal 2013. The increase in the average sales price of net contracts signed was primarily due to a shift in the number of contracts signed to more expensive areas and/or products and increases in selling prices in fiscal 2013.

We reported income before income taxes of \$67.9 million in fiscal 2013, as compared to \$18.9 million in fiscal 2012. The increase in the income before income taxes was primarily due higher earnings from the increased revenues and lower inventory impairment charges in fiscal 2013, as compared to fiscal 2012, offset, in part, by higher SG&A in fiscal 2013, as compared to fiscal 2012. We recognized inventory impairment charges of \$2.4 million and \$5.2 million in fiscal 2013 and 2012, respectively.

West

Revenues in fiscal 2013 were higher than those in fiscal 2012 by \$286.5 million, or 65.4%. The increase in revenues was attributable to a 35.6% increase in the number of homes delivered and a 22.0% increase in the average sales price of the homes delivered. The increase in the number of homes delivered was primarily due to a higher backlog at October 31, 2012, as compared to October 31, 2011, which was the result of an increase in the number of net contracts signed in fiscal 2012 as compared to fiscal 2011. The increase in the average price of the homes delivered was primarily due to a shift in the number of homes delivered to more expensive products and/or locations and increases in

selling prices in fiscal 2013.

The value of net contracts signed during fiscal 2013 increased \$312.9 million, or 47.9%, as compared to fiscal 2012. This increase was due to a 13.5% increase in the number of net contracts signed and a 30.3% increase in the average value of each net contract signed. The increase in the number of net contracts signed was primarily due to increased demand in fiscal 2013.

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The increase in the average sales price of net contracts signed was primarily due to a shift in the number of contracts signed to more expensive areas and/or products and increases in base selling prices in fiscal 2013.

In fiscal 2013, we reported income before income taxes of \$111.3 million, as compared to \$39.4 million in fiscal 2012. The increase in income before income taxes was primarily due to higher earnings from the increased revenues and lower cost of revenues as a percentage of revenues in fiscal 2013, as compared to fiscal 2012, offset, in part, by higher SG&A in fiscal 2013. Cost of revenues as a percentage of revenues was 78.3% of revenues in fiscal 2013, as compared to 82.7% in fiscal 2012. The decrease in cost of revenues as a percentage of revenues in fiscal 2013, as compared to fiscal 2012, was primarily due to a shift in the number of homes delivered to better margin products and/or locations and the impact of purchase accounting on the homes delivered in fiscal 2012 from our acquisition of CamWest.

City Living

Revenues in fiscal 2013 were lower than those in fiscal 2012 by \$26.0 million, or 13.2%. The decrease in revenues was primarily attributable to a 49.8% decrease in the number of homes delivered, offset, in part, by an increase of 72.9% in the average selling price of the homes delivered. The decrease in the number of homes delivered in fiscal 2013, as compared to fiscal 2012, was primarily due to a decrease in the number of homes delivered in two of our high-rise buildings located in the New York and New Jersey urban markets which substantially settled out in fiscal 2012, partially offset by the commencement of closing at The Touraine, a high-rise building located in the New York urban market. The increase in the average price of homes delivered in the fiscal 2013 period, as compared to the fiscal 2012 period, was primarily attributable to closings at The Touraine. In fiscal 2013, we closed 21 units at The Touraine with an average sales price of \$4.2 million for each unit. Excluding The Touraine, the average selling price of the homes delivered decreased by 2.3% primarily due to an increase in the number of homes delivered in the Philadelphia urban market which has lower average sales prices than other City Living markets.

The value of net contracts signed in fiscal 2013 was \$287.1 million, a 14.2% increase from the \$251.4 million of net contracts signed during fiscal 2012. This increase was primarily due to a 10.2% increase in the number of net contracts signed and a 3.6% increase in the average value of each net contract. The increase in the number of net contracts signed was primarily due to two high-rise buildings located in the New York and New Jersey urban markets (160 East 22nd Street in Manhattan and Maxwell Place in Hoboken, New Jersey) that opened in fiscal 2013, offset, in part, by net contracts signed in fiscal 2012 at two high-rise building which commenced sales in the second half of fiscal 2011. The increase in the average sales price of net contracts signed in fiscal 2013, as compared to fiscal 2012, was primarily attributable due to a shift in the number of contracts signed to more expensive areas and/or products and increases in base selling prices in fiscal 2013, as compared to the fiscal 2012 period.

In fiscal 2013, we reported income before income taxes of \$53.3 million, as compared to \$61.9 million in fiscal 2012. This decrease in income was primarily attributable to a decrease in income from unconsolidated entities from \$15.2 million in fiscal 2012 to \$1.2 million in fiscal 2013 and lower earnings from decreased revenues in fiscal 2013, as compared to 2012, partially offset by lower cost of revenues as a percentage of revenues in fiscal 2013, as compared to fiscal 2012. The decrease in income from unconsolidated entities was due principally to a decrease in income generated from two of our high-rise joint ventures where there were fewer units remaining for sale since fiscal 2012 as they have closed most or all of their condominium units. Cost of revenues as a percentage of revenues was 65.7% and 70.4% in fiscal 2013 and 2012, respectively. The decrease in cost of revenues as a percentage of revenue in fiscal 2013, as compared to fiscal 2012, was primarily due to the increase in the number of homes delivered at The Touraine which had better margins than other City Living locations.

Other

In fiscal 2013 and 2012, other loss before income taxes was \$77.3 million and \$84.2 million, respectively. The decrease in fiscal 2013, as compared to fiscal 2012, was primarily due to \$13.2 million of income from the previously-disclosed settlement of derivative litigation in fiscal 2013, increased income from our Gibraltar operations and investment in its structured asset joint venture, increased income from our ancillary operations, and higher earnings from land sales in fiscal 2013, as compared to fiscal 2012, partially offset by higher unallocated SG&A in fiscal 2013. The increase in unallocated SG&A in fiscal 2013 was primarily due to higher compensation, office and information technology expenses as a result of the increase in our business activity.

FISCAL 2012 COMPARED TO FISCAL 2011

North

Revenues in fiscal 2012 were higher than those in fiscal 2011 by \$29.9 million, or 9.3%. The increase in revenues was primarily attributable to a 5.0% increase in the number of homes delivered and an increase of 4.1% in the average selling price

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of the homes delivered. The increase in the number of homes delivered in fiscal 2012, as compared to fiscal 2011, was primarily due to an increase in the number of net contracts signed in fiscal 2012 as compared to fiscal 2011. The increase in the average price of homes delivered in fiscal 2012, as compared to fiscal 2011, was primarily attributable to a shift in the number of homes delivered to more expensive areas and/or products.

The value of net contracts signed in fiscal 2012 was \$445.2 million, a 35.8% increase from the \$327.8 million of net contracts signed during fiscal 2011. This increase was primarily due to a 29.5% increase in the number of net contracts signed and a 4.9% increase in the average value of each net contract. The increase in the number of net contracts signed was primarily due to a 9% increase in the number of selling communities and an improvement in home buyer demand in fiscal 2012 as compared to fiscal 2011. The increase in the average sales price of net contracts signed in fiscal 2012, as compared to fiscal 2011, was primarily attributable to a shift in the number of homes delivered to more expensive areas and/or products.

In fiscal 2012, we reported income before income taxes of \$13.9 million, as compared to \$11.5 million in fiscal 2011. This increase in income was primarily attributable to higher earnings from the increased revenues and lower inventory impairment charges in fiscal 2012, as compared to fiscal 2011, offset, in part, by higher SG&A. In fiscal 2012 and 2011, we recognized inventory impairment charges of \$1.8 million and \$3.8 million, respectively.

Mid-Atlantic

Revenues in fiscal 2012 were higher than those in fiscal 2011 by \$70.6 million, or 15.2%. The increase in revenues was primarily attributable to a 17.4% increase in the number of homes delivered, partially offset by a 1.9% decrease in the average selling price of the homes delivered. The increase in the number of homes delivered in fiscal 2012, as compared to fiscal 2011, was primarily due to a higher backlog at October 31, 2011, as compared to October 31, 2010, primarily in Pennsylvania and Virginia. The decrease in the average price of homes delivered in fiscal 2012, as compared to fiscal 2011, was primarily attributable to a shift in the number of homes delivered to less expensive areas and/or products.

The value of net contracts signed during fiscal 2012 increased by \$145.5 million, or 30.3%, from fiscal 2011. The increase was due to a 31.3% increase in the number of net contracts signed, partially offset by a 0.8% decrease in the average value of each net contract. The increase in the number of net contracts signed was primarily due to a 10% increase in the number of selling communities and an increase in home buyer demand in fiscal 2012, as compared to fiscal 2011. The decrease in the average sales price of net contracts signed was primarily due to a shift in the number of contracts signed to less expensive areas and/or products in fiscal 2012, as compared to fiscal 2011.

We reported income before income taxes in fiscal 2012 and 2011 of \$63.0 million and \$48.8 million, respectively. The increase in the income before income taxes in fiscal 2012 was primarily due to higher earnings from the increased revenues in fiscal 2012, as compared to fiscal 2011, offset, in part, by higher inventory impairment charges and SG&A in fiscal 2012, as compared to fiscal 2011. We recognized inventory impairment charges of \$6.0 million and \$4.3 million in fiscal 2012 and 2011, respectively.

South

Revenues in fiscal 2012 were higher than those in fiscal 2011 by \$88.5 million, or 32.4%. This increase was attributable to a 21.4% increase in the number of homes delivered and a 9.0% increase in the average price of the homes delivered. The increase in the number of homes delivered in fiscal 2012, as compared to fiscal 2011, was primarily due to a higher backlog at October 31, 2011, as compared to October 31, 2010, which was the result of an increase in the number of net contracts signed in fiscal 2011 as compared to fiscal 2010. The increase in the average price of the homes delivered in fiscal 2012, as compared to fiscal 2011, was primarily attributable to a shift in the number of homes delivered to more expensive areas and/or products in fiscal 2012, as compared to fiscal 2011. In fiscal 2012, the value of net contracts signed increased by \$203.5 million, or 53.8%, as compared to fiscal 2011. The increase was attributable to increases of 40.6% and 9.3% in the number and average value of net contracts signed, respectively. The increase in the number of net contracts signed in fiscal 2012, as compared to fiscal 2011, was primarily due to increased demand and an increase in the number of selling communities in fiscal 2012, as compared to fiscal 2011. The increase in the average sales price of net contracts signed was primarily due to a shift in the number of contracts signed to more expensive areas and/or products in fiscal 2012, as compared to fiscal 2011.

We reported income before income taxes of \$18.9 million in fiscal 2012, as compared to a loss before income taxes of \$25.3 million in fiscal 2011. The increase in the income before income taxes was primarily due to lower inventory impairment charges in fiscal 2012, as compared to fiscal 2011, \$15.2 million of impairment charges that we recognized on one of our investments in unconsolidated entities in fiscal 2011 which did not recur in 2012, and higher earnings from the increased

revenues in fiscal 2012, as compared to fiscal 2011. In fiscal 2012 and 2011, we recognized inventory impairment charges of \$5.2 million and \$20.8 million, respectively.

West

Revenues in fiscal 2012 were higher than those in fiscal 2011 by \$128.3 million, or 41.4%. The increase in revenues was attributable to a 53.7% increase in the number of homes delivered, offset, in part, by an 8.0% decrease in the average sales price of the homes delivered. The increase in the number of homes delivered was primarily attributable to home deliveries in Washington from CamWest. The decrease in the average price of the homes delivered was primarily due to a shift in the number of homes delivered to less expensive products and/or locations, primarily in Arizona and Washington, in fiscal 2012, as compared to fiscal 2011.

The value of net contracts signed during fiscal 2012 increased \$371.3 million, or 131.5%, as compared to fiscal 2011. This increase was due to a 122.1% increase in the number of net contracts signed and a 4.2% increase in the average value of each net contract signed. The increase in the number of net contracts signed was due to the addition of communities in Washington from CamWest where we entered into 254 net contracts in fiscal 2012 and an increase in the number of selling communities and demand in other states in fiscal 2012, as compared to fiscal 2011.

In fiscal 2012, we reported income before income taxes of \$39.4 million, as compared to a loss before income taxes of \$27.1 million in fiscal 2011. The increase in income before income taxes was primarily due to a \$25.7 million impairment charge that we recognized on our South Edge investment in fiscal 2011 which did not recur in fiscal 2012, a \$22.1 million decrease in inventory impairment charges and write-offs and higher earnings from the increased amount of revenues in fiscal 2012, as compared to fiscal 2011, offset, in part, by higher cost of revenues, excluding inventory impairment charges and interest, as a percentage of revenues, in fiscal 2012, as compared to fiscal 2011. In fiscal 2011, we recognized inventory impairment charges and write-offs of \$22.9 million, as compared to \$0.8 million in fiscal 2012. Cost of revenues as a percentage of revenues, excluding impairments and interest, was 78.2% of revenues in fiscal 2012, as compared to 75.9% in fiscal 2011. The increase in cost of revenues, excluding inventory impairment charges and interest, as a percentage of revenue in fiscal 2012, as compared to fiscal 2011, was primarily due to the impact of purchase accounting on the homes delivered in fiscal 2012 from our acquisition of CamWest, offset, in part, by improved margins in California and Nevada.

City Living

Revenues in fiscal 2012 were higher than those in fiscal 2011 by \$89.6 million, or 83.7%. The increase in revenues was primarily attributable to a 90.9% increase in the number of homes delivered, partially offset by a decrease of 3.8% in the average selling price of the homes delivered. The increase in the number of homes delivered in fiscal 2012, as compared to fiscal 2011, was primarily due to the commencement of settlements in fiscal 2012 at two of our high-rise buildings located in the New York and New Jersey urban markets and to a higher backlog at October 31, 2011, as compared to October 31, 2010. The decrease in the average price of homes delivered in fiscal 2012, as compared to fiscal 2011, was primarily attributable to a shift in the number of homes delivered to less expensive areas and/or products.

The value of net contracts signed in fiscal 2012 was \$251.4 million, an 84.8% increase from the \$136.0 million of net contracts signed during fiscal 2011. This increase was primarily due to a 48.3% increase in the number of net contracts signed and a 24.6% increase in the average value of each net contract. The increase in the number of net contracts signed was primarily due to three high-rise buildings located in the New York and New Jersey urban markets that opened in the second half of fiscal 2011 and an improvement in home buyer demand in fiscal 2012 as compared to fiscal 2011. The increase in the average sales price of net contracts signed in fiscal 2012, as compared to fiscal 2011, was primarily attributable to sales at two of our high-rise buildings located in the New York urban market that opened in the fourth quarter of fiscal 2011. In fiscal 2012, we signed 74 contracts at these buildings with an average sales value of approximately \$1.8 million each, as compared to 12 contacts with an average sales value of approximately \$1.6 million in fiscal 2011.

In fiscal 2012, we reported income before income taxes of \$61.9 million, as compared to \$39.2 million in fiscal 2011. This increase in income was primarily attributable to higher earnings from the increased revenues and lower cost of revenues as a percentage of revenues, in fiscal 2012, as compared to fiscal 2011, offset, in part, by a decrease in income from unconsolidated entities from \$31.9 million in fiscal 2011 to \$15.2 million in fiscal 2012 and by higher

SG&A. The lower cost of revenues as a percentage of revenues was primarily due to the initial closings at two of our high-rise buildings located in the New York and New Jersey urban markets which had higher margins than our other City Living markets. The \$16.7 million decrease in income from unconsolidated entities in fiscal 2012 was due principally to a decrease in income generated from two of our high-rise joint ventures where unit availability has diminished since fiscal 2011 as they have closed most or all of their condominium units.

Other

In fiscal 2012 and 2011, other loss before income taxes was \$84.2 million and \$76.5 million, respectively. The increase in the loss in fiscal 2012, as compared to fiscal 2011, was primarily due to higher unallocated SG&A in fiscal 2012, as compared to fiscal 2011, offset, in part, by an increase of income recognized from our Gibraltar operations in fiscal 2012, as compared to fiscal 2011. The increase in unallocated SG&A in fiscal 2012, as compared to fiscal 2011, was primarily due to increased compensation costs in fiscal 2012, as compared to fiscal 2011, and a reduction in SG&A in fiscal 2011 from an insurance claim recovery.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk primarily due to fluctuations in interest rates. We utilize both fixed-rate and variable-rate debt. For fixed-rate debt, changes in interest rates generally affect the fair market value of the debt instrument, but not our earnings or cash flow. Conversely, for variable-rate debt, changes in interest rates generally do not affect the fair market value of the debt instrument but do affect our earnings and cash flow. We do not have the obligation to prepay fixed-rate debt prior to maturity and, as a result, interest rate risk and changes in fair market value should not have a significant impact on such debt until we are required to refinance such debt.

At October 31, 2013, our debt obligations, principal cash flows by scheduled maturity, weighted-average interest rates and estimated fair value were as follows (\$ amounts in thousands):

Fiscal year of maturity	Fixed-rate debt		Variable-rate debt (a)	
	Amount	Weighted-average interest rate (%)	Amount	Weighted-average interest rate (%)
2014	\$297,899	4.82%	\$75,150	2.99%
2015	317,215	5.12%	150	0.25%
2016	9,182	5.41%	150	0.25%
2017	404,265	8.88%	150	0.25%
2018	1,839	5.81%	150	0.25%
Thereafter	1,389,613	4.47%	11,795	0.16%
Discount	(3,894))		
Total	\$2,416,119	5.35%	\$87,545	2.59%
Fair value at October 31, 2013	\$2,553,180		\$87,545	

Based upon the amount of variable-rate debt outstanding at October 31, 2013, and holding the variable-rate debt (a) balance constant, each 1% increase in interest rates would increase the interest incurred by us by approximately \$0.9 million per year.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Reference is made to the financial statements, listed in Item 15(a)(1) beginning on page F-1 of this report and which are incorporated herein by reference.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES**Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures**

Any controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints and the benefits of controls must be considered relative to costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected; however, our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives.

Our Chief Executive Officer and Chief Financial Officer, with the assistance of management, evaluated the effectiveness of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, (“Exchange Act”) as of the end of the period covered by this report (“Evaluation Date”). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the Evaluation Date, our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed in our reports under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Management’s Annual Report on Internal Control Over Financial Reporting and Attestation Report of the Independent Registered Public Accounting Firm

Management’s Annual Report on Internal Control Over Financial Reporting and the attestation report of our independent registered public accounting firm on internal control over financial reporting on pages F-1 and F-2, respectively, are incorporated herein.

Changes in Internal Control Over Financial Reporting

There has not been any change in our internal control over financial reporting (as that term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during our quarter ended October 31, 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

Not applicable.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The following table includes information with respect to all persons serving as executive officers as of the date of this Form 10-K. All executive officers serve at the pleasure of our Board of Directors.

Name	Age	Positions
Robert I. Toll	72	Executive Chairman of the Board and Director
Douglas C. Yearley, Jr.	53	Chief Executive Officer and Director
Richard T. Hartman	56	President and Chief Operating Officer
Martin P. Connor	49	Senior Vice President and Chief Financial Officer

Robert I. Toll, with his brother Bruce E. Toll, the Vice Chairman of the Board and a Director, co-founded our predecessors’ operations in 1967. Robert I. Toll served as Chairman of the Board and Chief Executive Officer from our inception until June 2010, when he assumed the new position of Executive Chairman of the Board.

Douglas C. Yearley, Jr. joined us in 1990 as assistant to the Chief Executive Officer with responsibility for land acquisitions. He has been an officer since 1994, holding the position of Senior Vice President from January 2002 until November 2005, the position of Regional President from November 2005 until November 2009, and the position of Executive Vice President from November 2009 until June 2010 when he was promoted to his current position of Chief Executive Officer. Mr. Yearley was elected a Director in June 2010.

Richard T. Hartman, joined us in 1980 and served in various positions with us, including Regional President from 2005 through 2011. He was appointed to the positions of Executive Vice President and Chief Operating Officer effective January 1, 2012. In December 2012, Mr. Hartman was appointed to the position of President effective January 1, 2013.

Martin P. Connor joined the Company as Vice President and Assistant Chief Financial Officer in December 2008 and was elected a Senior Vice President in December 2009. Mr. Connor was appointed to his current position of Senior Vice President and Chief Financial Officer in September 2010. From June 2008 to December 2008, Mr. Connor was President of Marcon Advisors LLC, a finance and accounting consulting firm which he founded. From October 2006 to June 2008, Mr. Connor was Chief Financial Officer and Director of Operations for O’Neill Properties, a diversified commercial real estate developer in the Mid-Atlantic area. Prior to October 2006, he spent over 20 years at Ernst & Young LLP as an Audit and Advisory Business

Services Partner, responsible for the real estate practice for Ernst & Young LLP in the Philadelphia marketplace. During the period from 1998 to 2005, he served on the Toll Brothers, Inc. engagement.

The other information required by this item will be included in the "Election of Directors" and "Corporate Governance" sections of our Proxy Statement for the 2014 Annual Meeting of Stockholders (the "2014 Proxy Statement").

Code of Ethics

We have adopted a Code of Ethics for the Principal Executive Officer and Senior Financial Officers ("Code of Ethics") that applies to our principal executive officer, principal financial officer, principal accounting officer, controller and persons performing similar functions designated by our Board of Directors. The Code of Ethics is available on our internet website at www.tollbrothers.com under "Investor Relations: Company Information: Corporate Governance." If we were to amend or waive any provision of our Code of Ethics, we intend to satisfy our disclosure obligations with respect to any such waiver or amendment by posting such information on our internet website set forth above rather than by filing a Form 8-K.

Indemnification of Directors and Officers

Our Certificate of Incorporation and Bylaws provide for indemnification of our directors and officers. We have also entered into individual indemnification agreements with each of our directors.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item will be included in the "Executive Compensation" section of our 2014 Proxy Statement and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required in this item will be included in the "Voting Securities and Beneficial Ownership" and "Equity Compensation Plan Termination" sections of our 2014 Proxy Statement and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS, RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

The information required in this item will be included in the "Corporate Governance" and "Certain Transactions" sections of our 2014 Proxy Statement and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required in this item will be included in the "Ratification of the Re-Appointment of Independent Registered Public Accounting Firm" section of the 2014 Proxy Statement and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) Financial Statements and Financial Statement Schedules

	Page
1. Financial Statements	
<u>Management's Annual Report on Internal Control Over Financial Reporting</u>	<u>F-1</u>
<u>Reports of Independent Registered Public Accounting Firm</u>	<u>F-2</u>
<u>Consolidated Balance Sheets</u>	<u>F-4</u>
<u>Consolidated Statements of Operations</u>	<u>F-5</u>
<u>Consolidated Statements of Comprehensive Income</u>	<u>F-5</u>
<u>Consolidated Statements of Changes in Equity</u>	<u>F-6</u>
<u>Consolidated Statements of Cash Flows</u>	<u>F-7</u>
<u>Notes to Consolidated Financial Statements</u>	<u>F-8</u>

2. Financial Statement Schedules

None

Financial statement schedules have been omitted because they are either not applicable or the required information is included in the financial statements or notes hereto.

(b) Exhibits

The following exhibits are included with this report or incorporated herein by reference:

Exhibit Number	Description
2.1	Purchase and Sale Agreement, dated as of November 6, 2013, among the Registrant and Shapell Investment Properties, Inc. is hereby incorporated by reference to Exhibit 2.1 of the Registrant's Form 8-K filed with the Securities and Exchange Commission on November 7, 2013.
3.1	Second Restated Certificate of Incorporation of the Registrant, dated September 8, 2005, is hereby incorporated by reference to Exhibit 3.1 of the Registrant's Form 10-Q for the quarter ended July 31, 2005.
3.2	Certificate of Amendment of the Second Restated Certificate of Incorporation of the Registrant, filed with the Secretary of State of the State of Delaware, is hereby incorporated by reference to Exhibit 3.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on March 22, 2010.
3.3	Certificate of Amendment of the Second Restated Certificate of Incorporation of the Registrant dated as of March 16, 2011 is hereby incorporated by reference to Exhibit 3.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on March 18, 2011.

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Exhibit Number	Description
3.4	By-laws of the Registrant, as Amended and Restated June 11, 2008, are hereby incorporated by reference to Exhibit 3.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on June 13, 2008.
3.5	Amendment to the By-laws of the Registrant, dated as of September 24, 2009, is hereby incorporated by reference to Exhibit 3.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on September 24, 2009.
3.6	Amendment to the By-laws of the Registrant, dated as of June 15, 2011 is hereby incorporated by reference to Exhibit 3.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on June 16, 2011.
4.1	Specimen Stock Certificate is hereby incorporated by reference to Exhibit 4.1 of the Registrant's Form 10-K for the fiscal year ended October 31, 1991.
4.2	Indenture dated as of November 22, 2002 among Toll Brothers Finance Corp., as issuer, the Registrant, as guarantor, and Bank One Trust Company, NA, as Trustee, including form of guarantee, is hereby incorporated by reference to Exhibit 4.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on November 27, 2002.
4.3	Authorizing Resolutions, dated as of March 9, 2004, relating to \$300,000,000 principal amount of 4.95% Senior Notes of Toll Brothers Finance Corp. due 2014, guaranteed on a senior basis by the Registrant and certain subsidiaries of the Registrant is hereby incorporated by reference to Exhibit 4.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on April 1, 2004.
4.4	Authorizing Resolutions, dated as of May 26, 2005, relating to \$300,000,000 principal amount of 5.15% Senior Notes of Toll Brothers Finance Corp. due 2015, guaranteed on a senior basis by the Registrant and certain subsidiaries of the Registrant is hereby incorporated by reference to Exhibit 4.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on June 8, 2005.
4.5	First Supplemental Indenture dated as of May 1, 2003 to the Indenture dated as of November 22, 2002 by and among the parties listed on Schedule A thereto, and Bank One Trust Company, National Association, as Trustee, is hereby incorporated by reference to Exhibit 4.4 of the Registrant's Registration Statement on Form S-4/A filed with the Securities and Exchange Commission on June 16, 2003, File Nos. 333-103931, 333-103931-01, 333-103931-02, 333-103931-03 and 333-103931-04.
4.6	Second Supplemental Indenture dated as of November 3, 2003 to the Indenture dated as of November 22, 2002 by and among the parties listed on Schedule A thereto, and Bank One Trust Company, National Association, as Trustee, is hereby incorporated by reference to Exhibit 4.5 of the Registrant's Registration Statement on Form S-4/A filed with the Securities and Exchange Commission on November 5, 2003, File Nos. 333-109604, 333-109604-01, 333-109604-02, 333-109604-03 and 333-109604-04.

4.7 Third Supplemental Indenture dated as of January 26, 2004 to the Indenture dated as of November 22, 2002 by and among the parties listed on Schedule A thereto, and J.P. Morgan Trust Company, National Association, as successor Trustee, is hereby incorporated by reference to Exhibit 4.1 of the Registrant's Form 10-Q for the quarter ended January 31, 2004.

4.8 Fourth Supplemental Indenture dated as of March 1, 2004 to the Indenture dated as of November 22, 2002 by and among the parties listed on Schedule A thereto, and J.P. Morgan Trust Company, National Association, as successor Trustee, is hereby incorporated by reference to Exhibit 4.2 of the Registrant's Form 10-Q for the quarter ended January 31, 2004.

4.9 Fifth Supplemental Indenture dated as of September 20, 2004 to the Indenture dated as of November 22, 2002 by and among the parties listed on Schedule A thereto, and J.P. Morgan Trust Company, National Association, as successor Trustee, is hereby incorporated by reference to Exhibit 4.9 of the Registrant's Form 10-K for the fiscal year ended October 31, 2004.

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Exhibit Number	Description
4.10	Sixth Supplemental Indenture dated as of October 28, 2004 to the Indenture dated as of November 22, 2002 by and among the parties listed on Schedule A thereto, and J.P. Morgan Trust Company, National Association, as successor Trustee, is hereby incorporated by reference to Exhibit 4.10 of the Registrant's Form 10-K for the fiscal year ended October 31, 2004.
4.11	Seventh Supplemental Indenture dated as of October 31, 2004 to the Indenture dated as of November 22, 2002 by and among the parties listed on Schedule A thereto, and J.P. Morgan Trust Company, National Association, as successor Trustee, is hereby incorporated by reference to Exhibit 4.11 of the Registrant's Form 10-K for the fiscal year ended October 31, 2004.
4.12	Eighth Supplemental Indenture dated as of January 31, 2005 to the Indenture dated as of November 22, 2002 by and among the parties listed on Schedule A thereto, and J.P. Morgan Trust Company, National Association, as successor Trustee, is hereby incorporated by reference to Exhibit 4.1 of the Registrant's Form 10-Q for the quarter ended April 30, 2005.
4.13	Ninth Supplemental Indenture dated as of June 6, 2005 to the Indenture dated as of November 22, 2002 by and among the parties listed on Schedule A thereto, and J.P. Morgan Trust Company, National Association, as successor Trustee, is hereby incorporated by reference to Exhibit 4.1 of the Registrant's Form 10-Q for the quarter ended July 31, 2005.
4.14	Tenth Supplemental Indenture dated as of August 1, 2005 to the Indenture dated as of November 22, 2002 by and among the parties listed on Schedule A thereto, and J.P. Morgan Trust Company, National Association, as successor Trustee, is hereby incorporated by reference to Exhibit 4.13 of the Registrant's Registration Statement on Form S-4 filed with the Securities and Exchange Commission on September 29, 2005, File Nos. 333-128683, 333-128683-01, 333-128683-02, 333-128683-03 and 333-128683-04.
4.15	Eleventh Supplemental Indenture dated as of January 31, 2006 to the Indenture dated as of November 22, 2002 by and among the parties listed on Schedule I thereto, and J.P. Morgan Trust Company, National Association, as successor Trustee, is hereby incorporated by reference to Exhibit 4.1 of the Registrant's Form 10-Q for the quarter ended April 30, 2006.
4.16	Twelfth Supplemental Indenture dated as of April 30, 2006 to the Indenture dated as of November 22, 2002 by and among the parties listed on Schedule I thereto, and J.P. Morgan Trust Company, National Association, as successor Trustee, is hereby incorporated by reference to Exhibit 4.1 of the Registrant's Form 10-Q for the quarter ended July 31, 2006.
4.17	Thirteenth Supplemental Indenture dated as of July 31, 2006 to the Indenture dated as of November 22, 2002 by and among the parties listed on Schedule I thereto, and J.P. Morgan Trust Company, National Association, as successor Trustee, is hereby incorporated by reference to Exhibit 4.16 of the Registrant's Form 10-K for the year ended October 31, 2006.
4.18	Fourteenth Supplemental Indenture dated as October 31, 2006 to the Indenture dated as of November 22, 2002 by and among the parties listed on Schedule I thereto, and The Bank of New York Trust Company, N.A. as successor Trustee, is hereby incorporated by reference to Exhibit 4.1 of the Registrant's Form 10-Q for the quarter ended April 30, 2007.

4.19 Fifteenth Supplemental Indenture dated as of June 25, 2007 to the Indenture dated as of November 22, 2002 by and among the parties listed on Schedule I thereto, and The Bank of New York Trust Company, N.A. as successor Trustee, is hereby incorporated by reference to Exhibit 4.1 of the Registrant's Form 10-Q for the quarter ended July 31, 2007.

4.20 Sixteenth Supplemental Indenture dated as of June 27, 2007 to the Indenture dated as of November 22, 2002 by and among the parties listed on Schedule I thereto, and The Bank of New York Trust Company, N.A. as successor Trustee, is hereby incorporated by reference to Exhibit 4.2 of the Registrant's Form 10-Q for the quarter ended July 31, 2007.

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Exhibit Number	Description
4.21	Seventeenth Supplemental Indenture dated as of January 31, 2008, to the Indenture dated as of November 22, 2002 by and among the parties listed on Schedule A thereto, and The Bank of New York Trust Company, N.A. as successor Trustee, is hereby incorporated by reference to Exhibit 4.1 of the Registrant's Form 10-Q for the quarter ended April 30, 2009.
4.22	Eighteenth Supplemental Indenture dated as of October 27, 2011, to the Indenture dated as of November 22, 2002 by and among the parties listed on Schedule A thereto, and The Bank of New York Mellon, as successor Trustee, is hereby incorporated by reference to Exhibit 4.1 of the Registrant's Form 10-Q for the quarter ended January 31, 2012.
4.23	Nineteenth Supplemental Indenture dated as of November 1, 2011, to the Indenture dated as of November 22, 2002 by and among the parties listed on Schedule A thereto, and The Bank of New York Mellon, as successor Trustee, is hereby incorporated by reference to Exhibit 4.2 of the Registrant's Form 10-Q for the quarter ended January 31, 2012.
4.24	Twentieth Supplemental Indenture dated as of April 27, 2012, to the Indenture dated as of November 22, 2002 by and among the parties listed on Schedule A thereto, and The Bank of New York Mellon, as successor Trustee, is hereby incorporated by reference to Exhibit 4.1 of the Registrant's Form 10-Q for the quarter ended April 30, 2012.
4.25	Twenty-first Supplemental Indenture dated as of February 1, 2013, to the Indenture dated as of November 22, 2002 by and among the parties listed on Schedule A thereto, and The Bank of New York Mellon, as successor Trustee, is hereby incorporated by reference to Exhibit 4.1 of the Registrant's Form 10-Q for the quarter ended April 30, 2013.
4.26	Twenty-second Supplemental Indenture dated as of April 30, 2013, to the Indenture dated as of November 22, 2002 by and among the parties listed on Schedule A thereto, and The Bank of New York Mellon, as successor Trustee, is hereby incorporated by reference to Exhibit 4.2 of the Registrant's Form 10-Q for the quarter ended April 30, 2013.
4.27	Indenture, dated as of April 20, 2009, among Toll Brothers Finance Corp., the Registrant and the other guarantors named therein and The Bank of New York Mellon, as trustee, is hereby incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on April 24, 2009.
4.28	Authorizing Resolutions, dated as of April 20, 2009, relating to the \$400,000,000 principal amount of 8.910% Senior Notes due 2017 of Toll Brothers Finance Corp. guaranteed on a Senior Basis by the Registrant and certain of its subsidiaries, is hereby incorporated by reference to Exhibit 4.2 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on April 24, 2009.
4.29	Form of Global Note for Toll Brothers Finance Corp.'s 8.910% Senior Notes due 2017 is hereby incorporated by reference to Exhibit 4.3 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on April 24, 2009.
4.30	

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Authorizing Resolutions, dated as of September 22, 2009, relating to the \$250,000,000 principal amount of 6.750% Senior Notes due 2019 of Toll Brothers Finance Corp. guaranteed on a Senior Basis by the Registrant and certain of its subsidiaries, is hereby incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on September 22, 2009.

4.31 Form of Global Note for Toll Brothers Finance Corp.'s 6.750% Senior Notes due 2019 is hereby incorporated by reference to Exhibit 4.2 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on September 22, 2009.

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- 4.32 First Supplemental Indenture dated as of October 27, 2011, to the Indenture dated as of April 20, 2009 by and among listed on Schedule A thereto, and The Bank of New York Mellon, as successor Trustee, is hereby incorporated by reference to Exhibit 4.3 of the Registrant's Form 10-Q for the quarter ended January 31, 2012.
- 4.33 Second Supplemental Indenture dated as of November 1, 2011, to the Indenture dated as of April 20, 2009 by and among parties listed on Schedule A thereto, and The Bank of New York Mellon, as successor Trustee, is hereby incorporated by reference to Exhibit 4.4 of the Registrant's Form 10-Q for the quarter ended January 31, 2012.
- 4.34 Third Supplemental Indenture dated as of April 27, 2012, to the Indenture dated as of April 20, 2009 by and among the parties listed on Schedule A thereto, and The Bank of New York Mellon, as successor Trustee, is hereby incorporated by reference to Exhibit 4.2 of the Registrant's Form 10-Q for the quarter ended April 30, 2012.
- 4.35 Fourth Supplemental Indenture dated as of April 30, 2013, to Indenture dated as of April 20, 2009 by and among the parties listed on Schedule A thereto, and The Bank of New York Mellon, as successor Trustee, is hereby incorporated by reference to Exhibit 4.3 of the Registrant's Form 10-Q for the quarter ended April 30, 2013.
- 4.36 Indenture, dated as of February 7, 2012, among Toll Brothers Finance Corp., the Registrant and the other guarantors listed therein and The Bank of New York Mellon, as trustee, is hereby incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on February 7, 2012.
- 4.37 Authorizing Resolutions, dated as of January 31, 2012, relating to the \$300,000,000 principal amount of 5.875% Senior Notes due 2022 of Toll Brothers Finance Corp. guaranteed on a Senior Basis by the Registrant and certain of its subsidiaries, is hereby incorporated by reference Exhibit 4.2 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on February 7, 2012.
- 4.38 Form of Global Note for Toll Brothers Finance Corp.'s 5.875% Senior Notes due 2022 is hereby incorporated by reference to Exhibit 4.3 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on February 7, 2012.
- 4.39 Authorizing Resolutions, dated as of April 3, 2013, relating to the \$300,000,000 principal amount of 4.375% Senior Notes due 2023 of Toll Brothers Finance Corp. guaranteed on a Senior Basis by the Registrant and certain of its subsidiaries, is hereby incorporated by reference to Exhibit 4.2 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on April 10, 2013.
- 4.40 Authorizing Resolutions, dated as of May 8, 2013, relating to the \$100,000,000 principal amount of 4.375% Senior Notes due 2023 of Toll Brothers Finance Corp. guaranteed on a Senior Basis by Toll Brothers, Inc. and certain of its subsidiaries, is hereby incorporated by reference to Exhibit 4.3 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on May 13, 2013.
- 4.41 Form of Global Note for Toll Brothers Finance Corp.'s 4.375% Senior Notes due 2023 is hereby incorporated by reference to Exhibit 4.3 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on May 13, 2013.
- 4.42 Authorizing Resolutions, dated as of November 21, 2013, relating to the \$350,000,000 principal amount of 4.000% Senior Notes due 2018 of Toll Brothers Finance Corp. guaranteed on a Senior Basis by the Registrant and certain of its subsidiaries, is hereby incorporated by reference to Exhibit 4.2 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on November 21, 2013.

Commission on November 21, 2013.

4.43 Form of Global Note for Toll Brothers Finance Corp.'s 4.000% Senior Notes due 2018 is hereby incorporated by reference to Exhibit 4.4 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on November 21, 2013.

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- 4.44 Authorizing Resolutions, dated as of November 21, 2013, relating to the \$250,000,000 principal amount of 5.625% Senior Notes due 2024 of Toll Brothers Finance Corp. guaranteed on a Senior Basis by the Registrant and certain of its subsidiaries incorporated by reference to Exhibit 4.3 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on November 21, 2013.
- 4.45 Form of Global Note for Toll Brothers Finance Corp.'s 5.625% Senior Notes due 2024 is hereby incorporated by reference to Exhibit 4.5 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on November 21, 2013.
- 4.46 First Supplemental Indenture dated as of April 27, 2012, to the Indenture dated as of February 7, 2012 by and among Toll Brothers Finance Corp. and the parties listed on Schedule A thereto, and The Bank of New York Mellon, as successor Trustee, is hereby incorporated by reference to Exhibit 4.3 of the Registrant's Form 10-Q for the quarter ended April 30, 2012.
- 4.47 Second Supplemental Indenture dated as of April 30, 2013, to the Indenture dated as of February 7, 2012 by and among Toll Brothers Finance Corp. and the parties listed on Schedule A thereto, and The Bank of New York Mellon, as successor Trustee, is hereby incorporated by reference to Exhibit 4.4 of the Registrant's Form 10-Q for the quarter ended April 30, 2013.
- 4.48 Indenture, dated as of September 11, 2012, among Toll Brothers Finance Corp., the Registrant and the other guarantors named therein and The Bank of New York Mellon, as trustee, is hereby incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on September 13, 2012.
- 4.49 First Supplemental Indenture dated as of April 30, 2013, to the Indenture dated as of September 11, 2012 by and among Toll Brothers Finance Corp. and the parties listed on Schedule A thereto, and The Bank of New York Mellon, as successor Trustee, is hereby incorporated by reference to Exhibit 4.5 of the Registrant's Form 10-Q for the quarter ended April 30, 2013.
- 4.50 Rights Agreement dated as of June 13, 2007, by and between the Registrant and American Stock Transfer & Trust Company, as Rights Agent, is hereby incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on June 18, 2007.
- 10.1 Credit Agreement by and among First Huntingdon Finance Corp., the Registrant and the lenders which are parties thereto, dated August 1, 2013, is hereby incorporated by reference to Exhibit 10.1 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on August 6, 2013.
- 10.2* Toll Brothers, Inc. Employee Stock Purchase Plan (amended and restated effective January 1, 2008) is hereby incorporated by reference to Exhibit 4.31 of the Registrant's Form 10-K for the year ended October 31, 2007.
- 10.3* Toll Brothers, Inc. Stock Incentive Plan (1998) is hereby incorporated by reference to Exhibit 4 of the Registrant's Registration Statement on Form S-8 filed with the Securities and Exchange Commission on June 25, 1998, File No. 333-57645.
- 10.4* Amendment to the Toll Brothers, Inc. Stock Incentive Plan (1998) effective March 22, 2001 is hereby incorporated by reference to Exhibit 10.4 of the Registrant's Form 10-Q for the quarter ended July 31, 2001.
- 10.5* Amendment to the Toll Brothers, Inc. Stock Incentive Plan (1998) effective December 12, 2007 is hereby incorporated by reference to Exhibit 10.4 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on March 18, 2008.

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- 10.6* Toll Brothers, Inc. Amended and Restated Stock Incentive Plan for Employees (2007) (amended and restated as of September 17, 2008, is hereby incorporated by reference to Exhibit 4.1 of the Registrant's Amendment No. 1 to Toll Inc.'s Registration Statement on Form S-8 (No. 333-143367) filed with the Securities and Exchange Commission on 2008.
- 10.7* Toll Brothers, Inc. Amended and Restated Stock Incentive Plan for Non-Employee Directors (2007) (amended and restated as of September 17, 2008) is hereby incorporated by reference to Exhibit 4.1 of the Registrant's Amendment No. 1 to Toll Inc.'s Registration Statement on Form S-8 (No. 333-144230) filed with the Securities and Exchange Commission on 2008.
- 10.8* Form of Non-Qualified Stock Option Grant pursuant to the Toll Brothers, Inc. Stock Incentive Plan for Employees (2007) is hereby incorporated by reference to Exhibit 10.1 of the Registrant's Form 8-K filed with the Securities and Exchange Commission on December 19, 2007.
- 10.9* Form of Addendum to Non-Qualified Stock Option Grant pursuant to the Toll Brothers, Inc. Stock Incentive Plan for Employees (2007) is hereby incorporated by reference to Exhibit 10.3 of the Registrant's Form 10-Q for the quarter ended July 31, 2007.
- 10.10* Form of Stock Award Grant pursuant to the Toll Brothers, Inc. Stock Incentive Plan for Employees (2007) is hereby incorporated by reference to Exhibit 10.4 of the Registrant's Form 10-Q for the quarter ended July 31, 2007.
- 10.11* Form of Restricted Stock Unit Award pursuant to the Toll Brothers, Inc. Amended and Restated Stock Incentive Plan for Employees (2007) is hereby incorporated by reference to Exhibit 10.19 of the Registrant's Form 10-K for the period ended October 31, 2008.
- 10.12* Restricted Stock Unit Award to Robert I. Toll, dated December 19, 2008, pursuant to the Toll Brothers, Inc. Amended and Restated Stock Incentive Plan for Employees (2007) is incorporated by reference to Exhibit 10.20 of the Registrant's Form 10-K for the period ended October 31, 2008.
- 10.13* Restricted Stock Unit Award to Robert I. Toll, dated December 21, 2009, pursuant to the Toll Brothers, Inc. Amended and Restated Stock Incentive Plan for Employees (2007) is incorporated by reference to Exhibit 10.17 of the Registrant's Form 10-K for the period ended October 31, 2009.
- 10.14* Form of Non-Qualified Stock Option Grant pursuant to the Toll Brothers, Inc. Stock Incentive Plan for Non-Employee Directors (2007) is hereby incorporated by reference to Exhibit 10.2 of the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on December 19, 2007.
- 10.15* Form of Addendum to Non-Qualified Stock Option Grant pursuant to the Toll Brothers, Inc. Amended and Restated Stock Incentive Plan for Non-Employee Directors (2007) is hereby incorporated by reference to Exhibit 10.6 of the Registrant's Form 10-Q for the quarter ended July 31, 2007.
- 10.16* Form of Stock Award Grant pursuant to the Toll Brothers, Inc. Stock Incentive Plan for Non-Employee Directors (2007) is hereby incorporated by reference to Exhibit 10.7 of the Registrant's Form 10-Q for the quarter ended July 31, 2007.
- 10.17* Form of Stock Award Amendment pursuant to the Toll Brothers, Inc. Amended and Restated Stock Incentive Plan for Non-Employee Directors (2007) is hereby incorporated by reference to Exhibit 10.4 of the Registrant's Form 10-Q for the period ended January 31, 2010.

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Toll Brothers, Inc. Senior Officer Bonus Plan is hereby incorporated by reference to Addendum C to Toll Brothers, Inc. definitive proxy statement on Schedule 14A for the Toll Brothers, Inc. 2010 Annual Meeting of Stockholders held on February 1, 2010 filed with the Securities and Exchange Commission on February 1, 2010.

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Exhibit Number	Description
10.19*	Toll Brothers, Inc. Supplemental Executive Retirement Plan (amended and restated effective as of December 12, 2007) is hereby incorporated by reference to Exhibit 10.1 to the Registrant's Form 10-Q for the quarter ended July 31, 2010.
10.20*	Agreement dated March 5, 1998 between the Registrant and Bruce E. Toll regarding Mr. Toll's resignation and related matters is hereby incorporated by reference to Exhibit 10.2 to the Registrant's Form 10-Q for the quarter ended April 30, 1998.
10.21*	Advisory and Non-Competition Agreement between the Registrant and Bruce E. Toll, dated as of November 1, 2010, is incorporated by reference to Exhibit 10.34 of the Registrant's Form 10-K for the period ended October 31, 2010.
10.22*	Toll Bros., Inc. Non-Qualified Deferred Compensation Plan, amended and restated as of November 1, 2008, is incorporated by reference to Exhibit 10.45 of the Registrant's Form 10-K for the period ended October 31, 2008.
10.23*	Amendment Number 1 dated November 1, 2010 to the Toll Bros., Inc. Non-Qualified Deferred Compensation Plan, amended and restated as of November 1, 2008, is incorporated by reference to Exhibit 10.40 of the Registrant's Form 10-K for the period ended October 31, 2010.
10.24*	Form of Indemnification Agreement between the Registrant and the members of its Board of Directors, is hereby incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on March 17, 2009.
10.25	Restricted Stock Unit Award to Douglas C. Yearley, Jr., dated December 20, 2010, pursuant to the Toll Brothers, Inc. Amended and Restated Stock Incentive Plan for Employees (2007), is incorporated by reference to Exhibit 10.42 of the Registrant's Form 10-K for the period ended October 31, 2010.
10.26*	Restricted Stock Unit Award to Martin P. Connor, dated December 20, 2010, pursuant to the Toll Brothers, Inc. Amended and Restated Stock Incentive Plan for Employees (2007), is incorporated by reference to Exhibit 10.43 of the Registrant's Form 10-K for the period ended October 31, 2010.
10.27*	Restricted Stock Unit Award to Robert I. Toll, dated December 20, 2010, pursuant to the Toll Brothers, Inc. Amended and Restated Stock Incentive Plan for Employees (2007), is incorporated by reference to Exhibit 10.44 of the Registrant's Form 10-K for the period ended October 31, 2010.
10.28*	Form of Performance Based Restricted Stock Unit Award pursuant to the Toll Brothers, Inc. Amended and Restated Stock Incentive Plan for Employees (2007), is incorporated by reference to Exhibit 10.33 of the Registrant's Form 10-K for the period ended October 31, 2011.
12**	Statement re: Computation of Ratios of Earnings to Fixed Charges.
21**	Subsidiaries of the Registrant.
23.1**	Consent of Ernst & Young LLP, Independent Registered Public Accountant.

23.2** Consent of WeiserMazars LLP, Independent Registered Public Accountant.

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Exhibit Number	Description
31.1**	Certification of Douglas C. Yearley, Jr. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2**	Certification of Martin P. Connor pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1**	Certification of Douglas C. Yearley, Jr. pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2**	Certification of Martin P. Connor pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99.1**	Financial Statements of TMF Kent Partners, LLC.
99.2**	Financial Statements of KTL 303 LLC.
101.INS**	XBRL Instance Document
101.SCH**	XBRL Schema Document
101.CAL**	XBRL Calculation Linkbase Document
101.LAB**	XBRL Labels Linkbase Document
101.PRE**	XBRL Presentation Linkbase Document
101.DEF**	XBRL Definition Linkbase Document

* This exhibit is a management contract or compensatory plan or arrangement required to be filed as an exhibit to this report.

** Filed electronically herewith.

The agreements and other documents filed as exhibits to this report are not intended to provide factual information or other disclosure other than with respect to the terms of the agreements or other documents themselves, and you should not rely on them for that purpose. In particular, any representations and warranties made by us in these agreements or other documents were made solely within the specific context of the relevant agreement or document and may not describe the actual state of affairs as of the date they were made or at any other time.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the Township of Horsham, Commonwealth of Pennsylvania on December 23, 2013.

TOLL BROTHERS, INC.

By: /s/ Douglas C. Yearly, Jr.
Douglas C. Yearly, Jr.
Chief Executive Officer
(Principal Executive Officer)

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

Signature	Title	Date
/s/ Robert I. Toll Robert I. Toll	Executive Chairman of the Board of Directors	December 23, 2013
/s/ Bruce E. Toll Bruce E. Toll	Vice Chairman of the Board and Director	December 23, 2013
/s/ Douglas C. Yearley, Jr. Douglas C. Yearley, Jr.	Chief Executive Officer and Director (Principal Executive Officer)	December 23, 2013
/s/ Richard T. Hartman Richard T. Hartman	Chief Operating Officer and President	December 23, 2013
/s/ Martin P. Connor Martin P. Connor	Senior Vice President and Chief Financial Officer (Principal Financial Officer)	December 23, 2013
/s/ Joseph R. Sicree Joseph R. Sicree	Senior Vice President and Chief Accounting Officer (Principal Accounting Officer)	December 23, 2013
Robert S. Blank	Director	
/s/ Edward G. Boehne Edward G. Boehne	Director	December 23, 2013
/s/ Richard J. Braemer Richard J. Braemer	Director	December 23, 2013
/s/ Christine N. Garvey Christine N. Garvey	Director	December 23, 2013
/s/ Carl B. Marbach Carl B. Marbach	Director	December 23, 2013
/s/ Stephen A. Novick	Director	December 23, 2013

Stephen A. Novick

/s/ Paul E. Shapiro

Director

December 23, 2013

Paul E. Shapiro

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Management's Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in the Securities Exchange Act Rule 13a-15(f). Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of our management, including our principal executive officer and our principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation under the framework in Internal Control — Integrated Framework, our management concluded that our internal control over financial reporting was effective as of October 31, 2013.

Our independent registered public accounting firm, Ernst & Young LLP, has issued its report, which is included herein, on the effectiveness of our internal control over financial reporting.

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of Toll Brothers, Inc.

We have audited Toll Brothers, Inc.'s internal control over financial reporting as of October 31, 2013, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework), (the COSO criteria). Toll Brothers, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Toll Brothers, Inc. maintained, in all material respects, effective internal control over financial reporting as of October 31, 2013, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Toll Brothers, Inc. as of October 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive income, changes in equity, and cash flows for each of the three years in the period ended October 31, 2013 of Toll Brothers, Inc. and our report dated December 23, 2013 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Philadelphia, Pennsylvania
December 23, 2013

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of Toll Brothers, Inc.

We have audited the accompanying consolidated balance sheets of Toll Brothers, Inc. as of October 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive income, changes in equity, and cash flows for each of the three years in the period ended October 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Toll Brothers, Inc. at October 31, 2013 and 2012, and the consolidated results of its operations and its cash flows for each of the three years in the period ended October 31, 2013, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Toll Brothers Inc.'s internal control over financial reporting as of October 31, 2013, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) and our report dated December 23, 2013 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Philadelphia, Pennsylvania

December 23, 2013

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CONSOLIDATED BALANCE SHEETS

(Amounts in thousands)

	October 31, 2013	2012
ASSETS		
Cash and cash equivalents	\$772,972	\$778,824
Marketable securities	52,508	439,068
Restricted cash	32,036	47,276
Inventory	4,650,412	3,732,703
Property, construction and office equipment, net	131,320	109,971
Receivables, prepaid expenses and other assets	229,295	173,042
Mortgage loans held for sale	113,517	86,386
Customer deposits held in escrow	46,888	29,579
Investments in and advances to unconsolidated entities	403,133	330,617
Investments in distressed loans	36,374	37,169
Investments in foreclosed real estate	72,972	58,353
Deferred tax assets, net of valuation allowances	286,032	358,056
	\$6,827,459	\$6,181,044
LIABILITIES AND EQUITY		
Liabilities		
Loans payable	\$107,222	\$99,817
Senior notes	2,321,442	2,080,463
Mortgage company warehouse loan	75,000	72,664
Customer deposits	212,669	142,977
Accounts payable	167,787	99,911
Accrued expenses	522,987	476,350
Income taxes payable	81,188	80,991
Total liabilities	3,488,295	3,053,173
Equity		
Stockholders' equity		
Preferred stock, none issued	—	—
Common stock, 169,353 and 168,690 shares issued at October 31, 2013 and 2012, respectively	1,694	1,687
Additional paid-in capital	441,677	404,418
Retained earnings	2,892,003	2,721,397
Treasury stock, at cost - 0 shares and 53 shares at October 31, 2013 and 2012, respectively	—	(983)
Accumulated other comprehensive loss	(2,387)	(4,819)
Total stockholders' equity	3,332,987	3,121,700
Noncontrolling interest	6,177	6,171
Total equity	3,339,164	3,127,871
	\$6,827,459	\$6,181,044
See accompanying notes		

CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in thousands, except per share data)

	Year ended October 31,		
	2013	2012	2011
Revenues	\$2,674,299	\$1,882,781	\$1,475,881
Cost of revenues	2,133,300	1,532,095	1,260,770
Selling, general and administrative	339,932	287,257	261,355
	2,473,232	1,819,352	1,522,125
Income (loss) from operations	201,067	63,429	(46,244)
Other:			
Income (loss) from unconsolidated entities	14,392	23,592	(1,194)
Other income - net	52,238	25,921	23,403
Interest expense	—	—	(1,504)
Expenses related to early retirement of debt			(3,827)
Income (loss) before income taxes	267,697	112,942	(29,366)
Income tax provision (benefit)	97,091	(374,204)	(69,161)
Net income	\$170,606	\$487,146	\$39,795
Income per share:			
Basic	\$1.01	\$2.91	\$0.24
Diluted	\$0.97	\$2.86	\$0.24
Weighted-average number of shares:			
Basic	169,288	167,346	167,140
Diluted	177,963	170,154	168,381
See accompanying notes			

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Amounts in thousands)

	Year ended October 31,		
	2013	2012	2011
Net income	\$170,606	\$487,146	\$39,795
Other comprehensive income (loss), net of tax:			
Change in pension liability	2,334	(1,839)	(1,934)
Change in fair value of available-for-sale securities	(186)	476)	(192)
Change in unrealized loss on derivative held by equity investee	284	(554)	
Other comprehensive income (loss)	2,432	(1,917)	(2,126)
Total comprehensive income	\$173,038	\$485,229	\$37,669
See accompanying notes			

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(Amounts in thousands)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accum- ulated Other Compre- hensive Loss	Non-Controlling Interest	Total Equity
	Shares	\$	\$	\$	\$	\$	\$	\$
Balance, November 1, 2010	166,413	1,664	360,006	2,194,456	(96)	(577)	3,560	2,559,013
Net income				39,795				39,795
Purchase of treasury stock			(1)		(49,102)			(49,103)
Exercise of stock options	2,236	23	23,156		1,940			25,119
Employee benefit plan issuances	15		285		126			411
Conversion of restricted stock units to stock	10		208		67			275
Stock-based compensation			8,626					8,626
Issuance of restricted stock and stock units	1		8,102					8,102
Other comprehensive loss						(2,325)		(2,325)
Capital contribution							2,638	2,638
Balance, October 31, 2011	168,675	1,687	400,382	2,234,251	(47,065)	(2,902)	6,198	2,592,551
Net income				487,146				487,146
Purchase of treasury stock					(505)			(505)
Exercise of stock options	13		(9,831)		44,472			34,641
Employee benefit plan issuances			174		301			475
Conversion of restricted stock units to stock			(1,814)		1,814			—
Stock-based compensation			7,411					7,411
Issuance of restricted stock and stock units	2		8,096					8,096
Other comprehensive loss						(1,917)		(1,917)
Loss attributable to non-controlling interest							(27)	(27)

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Balance, October 31, 2012	168,690	1,687	404,418	2,721,397	(983)	(4,819)	6,171	3,127,871
Net income				170,606				170,606
Purchase of treasury stock					(15,377)			(15,377)
Exercise of stock options	505	6	20,952		15,996			36,954
Employee benefit plan issuances			299		362			661
Conversion of restricted stock units to stock								—
Stock-based compensation			7,703					7,703
Issuance of restricted stock and stock units	149	1	8,305		2			8,308
Other comprehensive income						2,432		2,432
Loss attributable to non-controlling interest							(27)	(27)
Capital contribution							33	33
Balance, October 31, 2013	169,353	1,694	441,677	2,892,003	—	(2,387)	6,177	3,339,164
See accompanying notes								

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CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in thousands)

	Year ended October 31,		
	2013	2012	2011
Cash flow (used in) provided by operating activities:			
Net income	\$ 170,606	\$ 487,146	\$ 39,795
Adjustments to reconcile net income to net cash (used in) provided by operating activities:			
Depreciation and amortization	25,210	22,586	23,142
Stock-based compensation	19,041	15,575	12,494
Excess tax benefits from stock-based compensation	(24,417	) (5,776)
(Recovery) impairment of investments in unconsolidated entities	—	(2,311	) 40,870
Income from unconsolidated entities	(14,392	) (21,281	) (39,676
Distributions of earnings from unconsolidated entities	23,468	5,258	12,081
Income from distressed loans and foreclosed real estate	(16,312	) (12,444	) (5,113
Deferred tax provision (benefit)	75,219	41,810	(18,188
Change in deferred tax valuation allowances	(1,337	) (394,718	) 18,188
Inventory impairments and write-offs	4,523	14,739	51,837
Change in fair value of mortgage loans receivable and derivative instruments	174	(670	) 475
Gain on sale of marketable securities	(57	) (40)
Expenses related to early retirement of debt			3,827
Changes in operating assets and liabilities			
Increase in inventory	(941,314	) (195,948	) (215,738
Origination of mortgage loans	(743,497	) (651,618	) (630,294
Sale of mortgage loans	716,586	629,397	659,610
Decrease (increase) in restricted cash	15,240	(27,516	) 41,146
Increase in receivables, prepaid expenses and other assets	(51,794	) (36,497	) (5,619
Increase in customer deposits	52,383	44,383	13,175
Increase (decrease) in accounts payable and accrued expenses	100,463	(58,537	) (28,624
Decrease in income tax refund recoverable		—	141,590
Increase (decrease) in income taxes payable	21,244	(25,075	) (56,225
Net cash (used in) provided by operating activities	(568,963	) (171,537	) 58,753
Cash flow provided by (used in) investing activities:			
Purchase of property and equipment — net	(26,567	) (11,920	) (15,456
Purchase of marketable securities	(36,202	) (579,958	) (452,864
Sale and redemption of marketable securities	417,846	368,253	408,831
Investment in and advances to unconsolidated entities	(93,398	) (217,160	) (132
Return of investments in unconsolidated entities	69,809	38,368	43,309
Investment in distressed loans and foreclosed real estate	(26,155	) (30,090	) (66,867
Return of investments in distressed loans and foreclosed real estate	27,370	16,707	2,806
Acquisition of a business	—	(144,746) —
Net cash provided by (used) in investing activities	332,703	(560,546	) (80,373
Cash flow provided by (used in) financing activities:			
Net proceeds from issuance of senior notes	400,383	578,696	—
Proceeds from loans payable	1,164,531	1,002,934	921,251
Principal payments of loans payable	(1,195,524) (1,016,081) (952,621
Redemption of senior notes	(163,853) —	(58,837

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Proceeds from stock-based benefit plans	15,798	33,747	25,531
Excess tax benefits from stock-based compensation	24,417	5,776	—
Purchase of treasury stock	(15,377	) (505	) (49,102)
Change in noncontrolling interest	33		2,678
Net cash provided by (used in) financing activities	230,408	604,567	(111,100)
Net decrease in cash and cash equivalents	(5,852	) (127,516	) (132,720)
Cash and cash equivalents, beginning of year	778,824	906,340	1,039,060
Cash and cash equivalents, end of year	\$772,972	\$778,824	\$906,340
See accompanying notes			

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Notes to Consolidated Financial Statements

1. Significant Accounting Policies

Basis of Presentation

The accompanying consolidated financial statements include the accounts of Toll Brothers, Inc. (the “Company”), a Delaware corporation, and its majority-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated. Investments in 50% or less owned partnerships and affiliates are accounted for using the equity method unless it is determined that the Company has effective control of the entity, in which case the entity would be consolidated.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (“GAAP”) requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents

Liquid investments or investments with original maturities of three months or less are classified as cash equivalents. The carrying value of these investments approximates their fair value.

Marketable Securities

Marketable securities are classified as available-for-sale, and accordingly, are stated at fair value, which is based on quoted market prices. Changes in unrealized gains and losses are excluded from earnings and are reported as other comprehensive income, net of income tax effects, if any. The cost of marketable securities sold is based on the specific identification method.

Restricted Cash

Restricted cash primarily represents cash deposits collateralizing certain deductibles under insurance policies, outstanding letters of credit outside of our bank revolving credit facility and cash deposited into a voluntary employee benefit association to fund certain future employee benefits.

Inventory

Inventory is stated at cost unless an impairment exists, in which case it is written down to fair value in accordance with the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 360, “Property, Plant and Equipment” (“ASC 360”). In addition to direct land acquisition costs, land development costs and home construction costs, costs also include interest, real estate taxes and direct overhead related to development and construction, which are capitalized to inventory during the period beginning with the commencement of development and ending with the completion of construction. For those communities that have been temporarily closed, no additional capitalized interest is allocated to a community’s inventory until it reopens. While the community remains closed, carrying costs such as real estate taxes are expensed as incurred.

The Company capitalizes certain interest costs to qualified inventory during the development and construction period of its communities in accordance with ASC 835-20, “Capitalization of Interest” (“ASC 835-20”). Capitalized interest is charged to cost of revenues when the related inventory is delivered. Interest incurred on home building indebtedness in excess of qualified inventory, as defined in ASC 835-20, is charged to the Consolidated Statements of Operations in the period incurred.

Once a parcel of land has been approved for development and the Company opens one of its typical communities, it may take four or more years to fully develop, sell and deliver all the homes in such community. Longer or shorter time periods are possible depending on the number of home sites in a community and the sales and delivery pace of the homes in a community. The Company’s master planned communities, consisting of several smaller communities, may take up to ten years or more to complete. Because the Company’s inventory is considered a long-lived asset under GAAP, the Company is required, under ASC 360, to regularly review the carrying value of each community and write down the value of those communities for which it believes the values are not recoverable.

Current Communities: When the profitability of a current community deteriorates, the sales pace declines significantly, or some other factor indicates a possible impairment in the recoverability of the asset, the asset is reviewed for impairment by comparing the estimated future undiscounted cash flow for the community to its carrying value. If the estimated future undiscounted cash flow is less than the community's carrying value, the carrying value is written down to its estimated fair value. Estimated fair value is primarily determined by discounting the estimated future cash flow of each community. The impairment is charged to cost of revenues in the period in which the impairment is determined. In estimating the future undiscounted cash flow of a community, the Company uses various estimates such as: (i) the expected sales pace in a community, based upon general economic conditions that will have a short-term or long-term impact on the market in which the community is located and on competition within the market, including the number of home sites available and pricing and incentives being offered in other communities owned by the Company or by other builders; (ii) the expected sales prices and sales incentives to be offered in a community; (iii) costs expended to date and expected to be incurred in the future, including, but not limited to, land and land development, home construction, interest and overhead costs; (iv) alternative product offerings that may be offered in a community that will have an impact on sales pace, sales price, building cost or the number of homes that can be built on a particular site; and (v) alternative uses for the property such as the possibility of a sale of the entire community to another builder or the sale of individual home sites.

Future Communities: The Company evaluates all land held for future communities or future sections of current communities, whether owned or under contract, to determine whether or not it expects to proceed with the development of the land as originally contemplated. This evaluation encompasses the same types of estimates used for current communities described above, as well as an evaluation of the regulatory environment applicable to the land and the estimated probability of obtaining the necessary approvals, the estimated time and cost it will take to obtain the approvals and the possible concessions that will be required to be given in order to obtain them. Concessions may include cash payments to fund improvements to public places such as parks and streets, dedication of a portion of the property for use by the public or as open space or a reduction in the density or size of the homes to be built. Based upon this review, the Company decides (i) as to land under contract to be purchased, whether the contract will likely be terminated or renegotiated, and (ii) as to land owned, whether the land will likely be developed as contemplated or in an alternative manner, or should be sold. The Company then further determines whether costs that have been capitalized to the community are recoverable or should be written off. The write-off is charged to cost of revenues in the period in which the need for the write-off is determined.

The estimates used in the determination of the estimated cash flows and fair value of both current and future communities are based on factors known to the Company at the time such estimates are made and its expectations of future operations and economic conditions. Should the estimates or expectations used in determining estimated fair value deteriorate in the future, the Company may be required to recognize additional impairment charges and write-offs related to current and future communities.

Variable Interest Entities

The Company is required to consolidate variable interest entities ("VIEs") in which it has a controlling financial interest in accordance with ASC 810, "Consolidation" ("ASC 810"). A controlling financial interest will have both of the following characteristics: (i) the power to direct the activities of a VIE that most significantly impact the VIE's economic performance and (ii) the obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE.

The Company's variable interest in VIEs may be in the form of equity ownership, contracts to purchase assets, management services and development agreements between the Company and a VIE, loans provided by the Company to a VIE or other member and/or guarantees provided by members to banks and other parties.

The Company has a significant number of land purchase contracts and several investments in unconsolidated entities which it evaluates in accordance with ASC 810. The Company analyzes its land purchase contracts and the unconsolidated entities in which it has an investment to determine whether the land sellers and unconsolidated entities are VIEs and, if so, whether the Company is the primary beneficiary. The Company examines specific criteria and uses its judgment when determining if it is the primary beneficiary of a VIE. Factors considered in determining whether the Company is the primary beneficiary include risk and reward sharing, experience and financial condition

of other member(s), voting rights, involvement in day-to-day capital and operating decisions, representation on a VIE's executive committee, existence of unilateral kick-out rights or voting rights, level of economic disproportionality between the Company and the other member(s) and contracts to purchase assets from VIEs. The determination whether an entity is a VIE and, if so, whether the Company is primary beneficiary may require significant judgment.

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Property, Construction and Office Equipment

Property, construction and office equipment are recorded at cost and are stated net of accumulated depreciation of \$159.5 million and \$157.5 million at October 31, 2013 and 2012, respectively. Depreciation is recorded using the straight-line method over the estimated useful lives of the assets. In fiscal 2013, 2012 and 2011, the Company recognized \$10.8 million, \$8.1 million and \$9.8 million of depreciation expense, respectively.

Mortgage Loans Receivable

Residential mortgage loans held for sale are measured at fair value in accordance with the provisions of ASC 825, “Financial Instruments” (“ASC 825”). The Company believes the use of ASC 825 improves consistency of mortgage loan valuations between the date the borrower locks in the interest rate on the pending mortgage loan and the date of the mortgage loan sale. At the end of the reporting period, the Company determines the fair value of its mortgage loans held for sale and the forward loan commitments it has entered into as a hedge against the interest rate risk of its mortgage loans using the market approach to determine fair value. The evaluation is based on the current market pricing of mortgage loans with similar terms and values as of the reporting date and by applying such pricing to the mortgage loan portfolio. The Company recognizes the difference between the fair value and the unpaid principal balance of mortgage loans held for sale as a gain or loss. In addition, the Company recognizes the fair value of its forward loan commitments as a gain or loss. Interest income on mortgage loans held for sale is calculated based upon the stated interest rate of each loan. In addition, the recognition of net origination costs and fees associated with residential mortgage loans originated are expensed as incurred. These gains and losses, interest income and origination costs and fees are recognized in other income - net in the accompanying Consolidated Statements of Operations.

Investments in and Advances to Unconsolidated Entities

In accordance with ASC 323, “Investments—Equity Method and Joint Ventures”, the Company reviews each of its investments on a quarterly basis for indicators of impairment. A series of operating losses of an investee, the inability to recover the Company’s invested capital, or other factors may indicate that a loss in value of the Company’s investment in the unconsolidated entity has occurred. If a loss exists, the Company further reviews to determine if the loss is other than temporary, in which case, it writes down the investment to its fair value. The evaluation of the Company’s investment in unconsolidated entities entails a detailed cash flow analysis using many estimates including but not limited to expected sales pace, expected sales prices, expected incentives, costs incurred and anticipated, sufficiency of financing and capital, competition, market conditions and anticipated cash receipts, in order to determine projected future distributions.

Each of the unconsolidated entities evaluates its inventory in a similar manner as the Company. See “Inventory” above for more detailed disclosure on the Company’s evaluation of inventory. If a valuation adjustment is recorded by an unconsolidated entity related to its assets, the Company’s proportionate share is reflected in the Company’s income (loss) from unconsolidated entities with a corresponding decrease to its investment in unconsolidated entities.

The Company is a party to several joint ventures with unrelated parties to develop and sell land that is owned by the joint ventures. The Company recognizes its proportionate share of the earnings from the sale of home sites to other builders, including our joint venture partners. The Company does not recognize earnings from the home sites it purchases from these ventures, but reduces its cost basis in the home sites by its share of the earnings from those home sites.

The Company is also a party to several other joint ventures. The Company recognizes its proportionate share of the earnings and losses of its unconsolidated entities.

Investments in Non-performing Loan Portfolios and Foreclosed Real Estate

The Company’s investments in non-performing loan portfolios are initially recorded at cost which the Company believes is fair value. The fair value is determined by discounting the cash flows expected to be collected from the portfolios using a discount rate that management believes a market participant would use in determining fair value. Management estimates cash flows expected to be collected on a loan-by-loan basis considering the contractual terms of the loan, current and expected loan performance, the manner and timing of disposition, the nature and estimated fair value of real estate or other collateral, and other factors it deems appropriate. The estimated fair value of the loans at acquisition was significantly less than the contractual amounts due under the terms of the loan agreements.

Since, at the acquisition date, the Company expects to collect less than the contractual amounts due under the terms of the loans based, at least in part, on the assessment of the credit quality of the borrowers, the loans are accounted for in accordance with ASC Topic 310-30, "Loans and Debt Securities Acquired with Deteriorated Credit Quality" ("ASC 310-30"). Under ASC 310-30, the accretable yield, or the amount by which the cash flows expected to be collected at the acquisition date exceeds the

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estimated fair value of the loan, is recognized in other income - net over the estimated remaining life of the loan using a level yield methodology provided the Company does not presently have the intention to utilize real estate secured by the loans for use in its operations or significantly improving the collateral for resale. The difference between the contractually required payments of the loan as of the acquisition date and the total cash flows expected to be collected, or non-accretable difference, is not recognized.

Pursuant to ASC 310-30, the Company aggregates loans with common risk characteristics into pools for purposes of recognizing interest income and evaluating changes in estimated cash flows. Loan pools are evaluated as a single loan for purposes of placing the pool on non-accrual status or evaluating loan impairment. Generally, a loan pool is classified as non-accrual when management is unable to reasonably estimate the timing or amount of cash flows expected to be collected from the loan pool or has serious doubts about further collectability of principal or interest. Proceeds received on non-accrual loan pools generally are either applied against principal or reported as other income - net, depending on management's judgment as to the collectability of principal. For the fiscal years ended October 31, 2013, 2012 and 2011, none of the Company's loan pools were on non-accrual status.

A loan is removed from a loan pool only when the Company sells, forecloses or otherwise receives assets in satisfaction of the loan, or the loan is written off. Loans removed from a pool are removed at their amortized cost (unpaid principal balance less unamortized discount and provision for loan loss) as of the date of resolution.

The Company periodically re-evaluates cash flows expected to be collected for each loan pool based upon all available information as of the measurement date. Subsequent increases in cash flows expected to be collected are recognized prospectively through an adjustment to the loan pool's yield over its remaining life, which may result in a reclassification from non-accretable difference to accretable yield. Subsequent decreases in cash flows expected to be collected are evaluated to determine whether a provision for loan loss should be established. If decreases in expected cash flows result in a decrease in the estimated fair value of the loan pool below its amortized cost, the loan pool is deemed to be impaired and the Company will record a provision for loan losses to write the loan pool down to its estimated fair value. For the years ended October 31, 2013 and October 31, 2012, the Company recorded a provision for loan losses of \$0.7 million and \$2.3 million, respectively. There was no provision for loan losses recorded in the fiscal year ended October 31, 2011.

The Company's investments in non-performing loans are classified as held for investment because the Company has the intent and ability to hold them for the foreseeable future.

Foreclosed Real Estate Owned ("REO")

REO assets, either directly owned or owned through a participation arrangement, acquired through subsequent foreclosure or deed in lieu actions on non-performing loans are initially recorded at fair value based upon third-party appraisals, broker opinions of value, or internal valuation methodologies (which may include discounted cash flows, capitalization rate analysis or comparable transactional analysis). Unobservable inputs used in estimating the fair value of REO assets are based upon the best information available under the circumstances and take into consideration the financial condition and operating results of the asset, local market conditions, the availability of capital, interest and inflation rates and other factors deemed appropriate by management. REO assets acquired are reviewed to determine if they should be classified as "held and used" or "held for sale". REO classified as "held and used" is stated at carrying cost unless an impairment exists, in which case it is written down to fair value in accordance with ASC 360-10-35. REO classified as "held for sale" is carried at the lower of carrying amount or fair value less cost to sell. An impairment charge is recognized for any decreases in estimated fair value subsequent to the acquisition date. For both classifications, carrying costs incurred after the acquisition, including property taxes and insurance, are expensed.

Loan Sales

As part of its disposition strategy for the loan portfolios, the Company may sell certain loans to third-party purchasers. The Company recognizes gains or losses on the sale of mortgage loans when the loans have been legally isolated from the Company and it no longer maintains effective control over the transferred assets.

Fair Value Disclosures

The Company uses ASC 820, "Fair Value Measurements and Disclosures" ("ASC 820"), to measure the fair value of certain assets and liabilities. ASC 820 provides a framework for measuring fair value in accordance with GAAP, establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the

use of unobservable inputs when measuring fair value and requires certain disclosures about fair value measurements.

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The fair value hierarchy is summarized below:

- Level 1: Fair value determined based on quoted prices in active markets for identical assets or liabilities.
- Level 2: Fair value determined using significant observable inputs, generally either quoted prices in active markets for similar assets or liabilities or quoted prices in markets that are not active.
- Level 3: Fair value determined using significant unobservable inputs, such as pricing models, discounted cash flows or similar techniques.

Treasury Stock

Treasury stock is recorded at cost. Issuance of treasury stock is accounted for on a first-in, first-out basis. Differences between the cost of treasury stock and the re-issuance proceeds are charged to additional paid-in capital.

Revenue and Cost Recognition

The construction time of the Company's homes is generally less than one year, although some homes may take more than one year to complete. Revenues and cost of revenues from these home sales are recorded at the time each home is delivered and title and possession are transferred to the buyer. For single family detached homes, closing normally occurs shortly after construction is substantially completed. In addition, the Company has several high-rise/mid-rise projects that do not qualify for percentage of completion accounting in accordance with ASC 360, which are included in this category of revenues and costs. Based upon the current accounting rules and interpretations, the Company does not believe that any of its current or future communities currently qualify or will qualify in the future for percentage of completion accounting.

For the Company's standard attached and detached homes, land, land development and related costs, both incurred and estimated to be incurred in the future, are amortized to the cost of homes closed based upon the total number of homes to be constructed in each community. Any changes resulting from a change in the estimated number of homes to be constructed or in the estimated costs subsequent to the commencement of delivery of homes are allocated to the remaining undelivered homes in the community. Home construction and related costs are charged to the cost of homes closed under the specific identification method. The estimated land, common area development and related costs of master planned communities, including the cost of golf courses, net of their estimated residual value, are allocated to individual communities within a master planned community on a relative sales value basis. Any changes resulting from a change in the estimated number of homes to be constructed or in the estimated costs are allocated to the remaining home sites in each of the communities of the master planned community.

For high-rise/mid-rise projects that do not qualify for percentage of completion accounting, land, land development, construction and related costs, both incurred and estimated to be incurred in the future, are generally amortized to the cost of units closed based upon an estimated relative sales value of the units closed to the total estimated sales value. Any changes resulting from a change in the estimated total costs or revenues of the project are allocated to the remaining units to be delivered.

Forfeited customer deposits: Forfeited customer deposits are recognized in other income - net in the period in which the Company determines that the customer will not complete the purchase of the home and it has the right to retain the deposit.

Sales Incentives: In order to promote sales of its homes, the Company grants its home buyers sales incentives from time to time. These incentives will vary by type of incentive and by amount on a community-by-community and home-by-home basis. Incentives that impact the value of the home or the sales price paid, such as special or additional options, are generally reflected as a reduction in sales revenues. Incentives that the Company pays to an outside party, such as paying some or all of a home buyer's closing costs, are recorded as an additional cost of revenues. Incentives are recognized at the time the home is delivered to the home buyer and the Company receives the sales proceeds.

Advertising Costs

The Company expenses advertising costs as incurred. Advertising costs were \$11.6 million, \$11.4 million and \$11.1 million for the years ended October 31, 2013, 2012 and 2011, respectively.

Warranty Costs

The Company provides all of its home buyers with a limited warranty as to workmanship and mechanical equipment. The Company also provides many of its home buyers with a limited ten-year warranty as to structural integrity. The Company accrues for expected warranty costs at the time each home is closed and title and possession is transferred to the buyer. Costs are accrued based upon historical experience.

Insurance Costs

The Company accrues for the expected costs associated with the deductibles and self-insured amounts under its various insurance policies.

Stock-Based Compensation

The Company accounts for its stock-based compensation in accordance with ASC 718, "Compensation — Stock Compensation" ("ASC 718"). The Company uses a lattice model for the valuation for its stock option grants. The option pricing models used are designed to estimate the value of options that, unlike employee stock options and restricted stock units, can be traded at any time and are transferable. In addition to restrictions on trading, employee stock options and restricted stock units may include other restrictions such as vesting periods. Further, such models require the input of highly subjective assumptions, including the expected volatility of the stock price. Stock-based compensation expense is generally included in the Company's selling, general and administrative expenses in its Consolidated Statements of Operations.

Income Taxes

The Company accounts for income taxes in accordance with ASC 740, "Income Taxes" ("ASC 740"). Deferred tax assets and liabilities are recorded based on temporary differences between the amounts reported for financial reporting purposes and the amounts reported for income tax purposes. In accordance with the provisions of ASC 740, the Company assesses the realizability of its deferred tax assets. A valuation allowance must be established when, based upon available evidence, it is more-likely-than-not that all or a portion of the deferred tax assets will not be realized. See "Income Taxes — Valuation Allowance" below.

Federal and state income taxes are calculated on reported pre-tax earnings (losses) based on current tax law and also include, in the applicable period, the cumulative effect of any changes in tax rates from those used previously in determining deferred tax assets and liabilities. Such provisions (benefits) differ from the amounts currently receivable or payable because certain items of income and expense are recognized for financial reporting purposes in different periods than for income tax purposes. Significant judgment is required in determining income tax provisions (benefits) and evaluating tax positions. The Company establishes reserves for income taxes when, despite the belief that its tax positions are fully supportable, it believes that its positions may be challenged and disallowed by various tax authorities. The consolidated tax provisions (benefits) and related accruals include the impact of such reasonably estimable disallowances as deemed appropriate. To the extent that the probable tax outcome of these matters changes, such changes in estimates will impact the income tax provision (benefit) in the period in which such determination is made.

ASC 740 clarifies the accounting for uncertainty in income taxes recognized and prescribes a recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. ASC 740 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. ASC 740 requires a company to recognize the financial statement effect of a tax position when it is "more-likely-than-not" (defined as a substantiated likelihood of more than 50%), based on the technical merits of the position, that the position will be sustained upon examination. A tax position that meets the "more-likely-than-not" recognition threshold is measured to determine the amount of benefit to be recognized in the financial statements based upon the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. The inability of the Company to determine that a tax position meets the "more-likely-than-not" recognition threshold does not mean that the Internal Revenue Service ("IRS") or any other taxing authority will disagree with the position that the Company has taken.

If a tax position does not meet the "more-likely-than-not" recognition threshold, despite the Company's belief that its filing position is supportable, the benefit of that tax position is not recognized in the Consolidated Statements of

Operations and the Company is required to accrue potential interest and penalties until the uncertainty is resolved. Potential interest and penalties are recognized as a component of the provision for income taxes which is consistent with the Company's historical accounting policy. Differences between amounts taken in a tax return and amounts recognized in the financial statements are considered unrecognized tax benefits. The Company believes that it has a reasonable basis for each of its filing positions and intends to

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defend those positions if challenged by the IRS or other taxing jurisdiction. If the IRS or other taxing authorities do not disagree with the Company's position, and after the statute of limitations expires, the Company will recognize the unrecognized tax benefit in the period that the uncertainty of the tax position is eliminated.

Income Taxes — Valuation Allowance

Significant judgment is applied in assessing the realizability of deferred tax assets. In accordance with GAAP, a valuation allowance is established against a deferred tax asset if, based on the available evidence, it is more-likely-than-not that such asset will not be realized. The realization of a deferred tax asset ultimately depends on the existence of sufficient taxable income in either the carryback or carryforward periods under tax law. The Company assesses the need for valuation allowances for deferred tax assets based on GAAP's "more-likely-than-not" realization threshold criteria. In the Company's assessment, appropriate consideration is given to all positive and negative evidence related to the realization of the deferred tax assets. Forming a conclusion that a valuation allowance is not needed is difficult when there is significant negative evidence such as cumulative losses in recent years. This assessment considers, among other matters, the nature, consistency and magnitude of current and cumulative income and losses, forecasts of future profitability, the duration of statutory carryback or carryforward periods, the Company's experience with operating loss and tax credit carryforwards being used before expiration, and tax planning alternatives.

The Company's assessment of the need for a valuation allowance on its deferred tax assets includes assessing the likely future tax consequences of events that have been recognized in its consolidated financial statements or tax returns. Changes in existing tax laws or rates could affect the Company's actual tax results and its future business results may affect the amount of its deferred tax liabilities or the valuation of its deferred tax assets over time. The Company's accounting for deferred tax assets represents its best estimate of future events.

Due to uncertainties in the estimation process, particularly with respect to changes in facts and circumstances in future reporting periods (carryforward period assumptions), actual results could differ from the estimates used in the Company's analysis. The Company's assumptions require significant judgment because the residential home building industry is cyclical and is highly sensitive to changes in economic conditions. If the Company's results of operations are less than projected and there is insufficient objectively verifiable positive evidence to support the "more-likely-than-not" realization of its deferred tax assets, a valuation allowance would be required to reduce or eliminate its deferred tax assets.

Noncontrolling Interest

The Company has a 67% interest in an entity that is developing land. The financial statements of this entity are consolidated in the Company's consolidated financial statements. The amounts shown in the Company's Consolidated Balance Sheets under "Noncontrolling interest" represent the noncontrolling interest attributable to the 33% minority interest not owned by the Company.

Segment Reporting

At October 31, 2013, the Company determined that it operates in two segments: Traditional Home Building and Urban Infill ("City Living"). Amounts reported in prior years have been reclassified to conform to the fiscal 2013 presentation.

The Company has determined that its Traditional Home Building operations operate in four geographic segments: North, Mid-Atlantic, South and West. The states comprising each geographic segment are as follows:

North: Connecticut, Illinois, Massachusetts, Michigan, Minnesota, New Jersey and New York

Mid-Atlantic: Delaware, Maryland, Pennsylvania and Virginia

South: Florida, North Carolina and Texas

West: Arizona, California, Colorado, Nevada and Washington

In fiscal 2011, the Company discontinued the sale of homes in South Carolina. The operations in South Carolina were immaterial to the South geographic segments.

Related Party Transactions

See Note 4, "Investments in and Advances to Unconsolidated Entities" for information regarding Toll Brothers Realty Trust ("Trust").

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Recent Accounting Pronouncements

In April 2013, the FASB issued Accounting Standards Update ("ASU") 2013-04, "Liabilities" ("ASU 2013-04"), which provides guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date. ASU 2013-04 is effective for the Company beginning November 1, 2014. The adoption of ASU 2013-04 is not expected to have a material effect on our consolidated financial statements or disclosures.

In February 2013, the FASB issued ASU No. 2013-02, "Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income" ("ASU 2013-02"). ASU 2013-02 requires entities to present information about reclassification adjustments from accumulated other comprehensive income in their financial statements, in a single note or on the face of the financial statements. The Company adopted ASU 2013-02 in its quarter beginning February 1, 2013. The adoption of this guidance, which relates to disclosure only, did not have a material impact on the Company's consolidated financial position, results of operations or cash flows.

Subsequent Events

Acquisition of Shapell Industries, Inc.

On November 6, 2013, the Company entered into a purchase and sale agreement (the "Purchase Agreement") with Shapell Investment Properties, Inc. to acquire all of the equity interests in Shapell Industries, Inc. ("Shapell"), for an aggregate all-cash purchase price of \$1.60 billion (the "Acquisition"), subject to certain adjustments. Pursuant to the Purchase Agreement, the Company has agreed to acquire the single-family residential real property development business of Shapell, including a portfolio of approximately 5,200 home sites in California. The Purchase Agreement contains customary representations, warranties and covenants of the parties. The closing of the Acquisition is subject to the the completion of the separation of Shapell's commercial and multi-family units to be retained by Shapell, subject to limited exceptions, the completion of pending buy-outs by Shapell of minority interests in certain joint ventures and other customary closing conditions and is expected to occur in the first calendar quarter of 2014. The Company intends to use the net proceeds of the equity offering and senior note offerings completed in November 2013, borrowings under its \$1.04 billion credit facility, other financial resources available to it, and, if needed, borrowings under the 364-day unsecured revolving credit facility as more fully described below, to finance the Acquisition and to pay related fees and expenses.

Equity Offering

In November 2013, the Company issued 7.2 million shares of its common stock, par value \$.01 per share, at a price to the public of \$32.00 per share (the "equity offering"). The Company received \$220.8 million of net proceeds from the issuance.

Senior Note Offerings

In November 2013, the Company issued \$350 million principal amount of 4.0% Senior Notes due 2018 (the "4.0% Senior Notes") and \$250 million principal amount of 5.625% Senior Notes due 2024 (the "5.625% Senior Notes") through Toll Brothers Finance Corp. The Company received \$596.2 million of net proceeds from the issuance of the 4.0% Senior Notes and the 5.625% Senior Notes. If (i) the Purchase Agreement is terminated on any date prior to May 31, 2014, (ii) the Company publicly announces on any date prior to May 31, 2014 that the Acquisition will not be pursued or (iii) the Acquisition is not consummated prior to May 31, 2014, then the Company will be required to redeem each series of notes at 100% of the aggregate principal amount of such series, together with accrued and unpaid interest on such notes from November 21, 2013 up to, but not including, the applicable special mandatory redemption date.

364-Day Senior Unsecured Revolving Credit Facility

The Company has received a definitive financing commitment from a number of banks for a \$500 million, 364-day senior unsecured revolving credit facility. The availability of borrowings under this facility is subject to the Company

entering into a definitive agreement with the banks and will be subject to customary conditions. Amounts borrowed thereunder are expected to accrue interest at the London interbank offered rate plus a margin determined pursuant to a leverage ratio-based pricing grid expected to range from 1.25% to 2.25% per annum.

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Sale of Toll Brothers Realty Trust II Assets

In December 2013, Trust II sold substantially all of its assets to an unrelated party. As a result of this sale, the Company expects to realize a profit of approximately \$20 million in the first quarter of fiscal 2014 representing its share of the gain on the sale. This gain will be included in income from unconsolidated entities in the Company's Consolidated Statements of Operations.

Reclassification

Certain prior period amounts have been reclassified to conform to the fiscal 2013 presentation.

2. Acquisition

In November 2011, the Company acquired substantially all of the assets of CamWest Development LLC ("CamWest") for approximately \$144.7 million in cash. The assets acquired were primarily inventory. As part of the acquisition, the Company assumed contracts to deliver approximately 29 homes with an aggregate value of \$13.7 million. The average price of the undelivered homes at the date of acquisition was approximately \$471,000. The assets the Company acquired included approximately 1,245 home sites owned and 254 home sites controlled through land purchase agreements. The Company's selling community count increased by 15 communities at the acquisition date. The acquisition of the assets of CamWest was not material to the Company's results of operations or its financial condition. In fiscal 2012, the Company delivered 201 homes and generated revenues of \$99.7 million through its CamWest operations.

3. Inventory

Inventory at October 31, 2013 and 2012 consisted of the following (amounts in thousands):

	2013	2012
Land controlled for future communities	\$99,802	\$54,624
Land owned for future communities	1,287,630	1,013,565
Operating communities	3,262,980	2,664,514
	\$4,650,412	\$3,732,703

Operating communities include communities offering homes for sale, communities that have sold all available home sites but have not completed delivery of the homes, communities that were previously offering homes for sale but are temporarily closed due to business conditions or non-availability of improved home sites and that are expected to reopen within twelve months of the end of the fiscal year being reported on and communities preparing to open for sale. The carrying value attributable to operating communities includes the cost of homes under construction, land and land development costs, the carrying cost of home sites in current and future phases of these communities and the carrying cost of model homes.

Communities that were previously offering homes for sale but are temporarily closed due to business conditions that do not have any remaining backlog and are not expected to reopen within twelve months of the end of the fiscal period being reported on have been classified as land owned for future communities. Backlog consists of homes under contract but not yet delivered to the Company's home buyers ("backlog").

Information regarding the classification, number and carrying value of these temporarily closed communities at October 31, 2013, 2012 and 2011 is provided in the table below (\$ amounts in thousands).

	2013	2012	2011
Land owned for future communities:			
Number of communities	25	40	43
Carrying value (in thousands)	\$153,498	\$240,307	\$256,468
Operating communities:			
Number of communities	15	5	2
Carrying value (in thousands)	\$88,534	\$34,685	\$11,076

The Company provided for inventory impairment charges and the expensing of costs that it believed not to be recoverable in each of the three fiscal years ended October 31, 2013, 2012 and 2011 as shown in the table below (amounts in thousands).

Charge:	2013	2012	2011
Land controlled for future communities	\$1,183	\$451	\$17,752
Land owned for future communities	—	1,218	17,000
Operating communities	3,340	13,070	17,085
	\$4,523	\$14,739	\$51,837

See Note 12, "Fair Value Disclosures", for information regarding the number of operating communities that the Company tested for potential impairment, the number of operating communities in which it recognized impairment charges, the amount of impairment charges recognized, and the fair value of those communities, net of impairment charges.

See Note 15, "Commitments and Contingencies" for information regarding land purchase commitments.

At October 31, 2013, the Company evaluated its land purchase contracts to determine if any of the selling entities were variable interest entities ("VIEs") and, if they were, whether the Company was the primary beneficiary of any of them. Under these land purchase contracts, the Company does not possess legal title to the land and its risk is generally limited to deposits paid to the sellers and the creditors of the sellers generally have no recourse against the Company. At October 31, 2013, the Company determined that 87 land purchase contracts, with an aggregate purchase price of \$1.12 billion, on which it had made aggregate deposits totaling \$51.9 million, were VIEs and that it was not the primary beneficiary of any VIE related to its land purchase contracts.

Interest incurred, capitalized and expensed in each of the three fiscal years ended October 31, 2013, 2012 and 2011 was as follows (amounts in thousands):

	2013	2012	2011
Interest capitalized, beginning of year	\$330,581	\$298,757	\$267,278
Interest incurred	134,198	125,783	114,761
Interest expensed to cost of revenues	(112,321)	(87,117)	(77,623)
Interest directly expensed in the consolidated statements of operations	—	—	(1,504)
Write-off against other income	(2,917)	(3,404)	(1,155)
Interest reclassified to property, construction and office equipment			(3,000)
Capitalized interest applicable to investments in unconsolidated entities	(6,464)	(3,438)	
Interest capitalized, end of year	\$343,077	\$330,581	\$298,757

Inventory impairment charges are recognized against all inventory costs of a community, such as land, land improvements, cost of home construction and capitalized interest. The amounts included in the table directly above reflect the gross amount of capitalized interest without allocation of any impairment charges recognized. The Company estimates that, had inventory impairment charges been allocated on a pro rata basis to the individual components of inventory, capitalized interest at October 31, 2013, 2012 and 2011 would have been reduced by approximately \$38.2 million, \$47.9 million and \$54.0 million, respectively.

During fiscal 2013, the Company reclassified \$28.5 million of land inventory primarily related to commercial properties located in two of its master planned communities to receivables, prepaid expenses and other assets. The \$28.5 million was reclassified due to the substantial completion of the home building operations in the communities where the land is located. The consolidated balance sheet as of October 31, 2012 was reclassified to conform to the fiscal 2013 presentation.

During fiscal 2013 and 2012, the Company contributed \$54.8 million and \$5.8 million, respectively, of inventory and other assets to several unconsolidated entities. See Note 4, "Investments in and Advances to Unconsolidated Entities" for more information related these transfers.

During fiscal 2013 and 2011, the Company reclassified \$5.6 million and \$20.0 million, respectively, of inventory related to commercial retail space located in two of its high-rise projects to property, construction and office

equipment. The amounts were reclassified due to the substantial completion of these projects.

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4. Investments in and Advances to Unconsolidated Entities

The Company has investments in and advances to various unconsolidated entities. The Company's investments in these entities are accounted for using the equity method of accounting. These entities include development joint ventures, home building joint ventures, rental joint ventures, the Trust, Trust II and a structured asset joint venture. At October 31, 2013, the Company had investments in and advances to these unconsolidated entities of \$403.1 million and was committed to invest or advance up to an additional \$92.1 million to these entities if they require additional funding. At October 31, 2013, the Company has guaranteed approximately \$25.2 million of loans, \$9.6 million of ground lease payments and \$2.0 million of insurance policy deductibles.

In fiscal 2013 and 2012, the Company recognized income from the unconsolidated entities in which it had an investment of \$14.4 million and \$23.6 million, respectively. In fiscal 2011, the Company recognized a loss from the unconsolidated entities in which it had an investment of \$1.2 million including \$40.9 million of impairment losses related to the settlement of a lawsuit by one of its development joint ventures and an impairment of one of its home building joint ventures. The Company did not recognize any impairment charges in connection with its joint ventures in fiscal 2013 or 2012. In fiscal 2012, the Company recovered \$2.3 million of costs it previously incurred.

In fiscal 2011, the Company recognized impairment charges in connection with the settlement of a lawsuit by one of its development joint ventures as noted above. As a result of the settlement, the Company recorded a charge of \$25.7 million above amounts previously provided. This fiscal 2011 impairment and recovery in fiscal 2012 was attributable to the Company's investment in South Edge LLC, and its successor entity, Inspirada Builders, LLC (collectively, "Inspirada"). Inspirada settled litigation regarding a loan made by a syndicate of lenders to it having a principal balance of \$327.9 million, for which the Company had executed certain completion guarantees and conditional repayment guarantees. The Company paid \$57.6 million in November 2011 to settle this matter. The disposition of the above matter did not have a material adverse effect on the Company's results of operations and liquidity or on its financial condition.

In addition, in fiscal 2011, due to the deterioration of the market in which one of its home building joint ventures operates, the Company determined that there was an other than temporary impairment of its investment in this joint venture. Based on this determination, the Company recognized \$15.2 million of impairment charges against the carrying value of the Company's investment in this joint venture.

More specific information regarding its investments in, advances to and future commitments to these entities is provided below.

Development Joint Ventures

The Company has investments in and advances to a number of joint ventures with unrelated parties to develop land ("Development Joint Ventures"). Some of these Development Joint Ventures develop land for the sole use of the venture participants, including the Company, and others develop land for sale to the joint venture participants and to unrelated builders. The Company recognizes its share of earnings from the sale of home sites by the Development Joint Ventures to other builders. With regard to home sites the Company purchases from the Development Joint Ventures, the Company reduces its cost basis in those home sites by its share of the earnings on the home sites. At October 31, 2013, the Company had approximately \$142.4 million invested in or advanced to its Development Joint Ventures. In addition, the Company has a funding commitment of \$26.0 million to three Development Joint Ventures should an additional investment in these ventures be required.

In the fourth quarter of fiscal 2013, the Company entered into a joint venture with an unrelated party to develop a parcel of land in Maryland. The property consists of 945 acres which the joint venture expects to develop into approximately 1,300 home sites. The Company has a 50% interest in this joint venture. The current plan is to develop the property and sell approximately 50% of the home sites to each of the members of the joint venture. The Company contributed \$11.8 million of cash to the joint venture.

In the second quarter of fiscal 2013, the Company entered into a joint venture with an unrelated party to develop a parcel of land in Texas as a master planned community consisting of approximately 2,900 home sites. The Company has a 50% interest in this joint venture. The current plan is to develop the property in multiple phases and sell groups of home sites to the members of the joint venture and to other home builders. The Company contributed \$15.5 million of cash to the joint venture. The joint venture entered into a \$25.0 million line of credit with a bank, secured by a deed

of trust on the property, which can be expanded up to \$40.0 million under certain conditions. At October 31, 2013, the joint venture had \$22.9 million of borrowings under this line of credit. At October 31, 2013, the Company had an investment of \$20.1 million in this joint venture and was committed to make additional contributions to this joint venture of up to \$12.5 million.

In the third quarter of fiscal 2012, the Company acquired for approximately \$110.0 million, a 50% interest in a joint venture with an unrelated party that owns and is developing over 2,000 home sites in Orange County, California. Under the terms of the

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operating agreement, the Company will acquire 266 home sites in the first phase of the property from the joint venture. The Company intends to acquire approximately 545 additional home sites in future phases from the joint venture. At October 31, 2013, the Company had an investment of \$105.2 million in this joint venture and was committed to make additional contributions of up to \$10.0 million to this joint venture, if needed. The joint venture has an \$80.0 million credit facility from a bank to fund the development of the property. At October 31, 2013, the venture had borrowed \$42.8 million under the facility.

Home Building Joint Ventures

At October 31, 2013, the Company had an aggregate of \$166.3 million of investments in and advances to various joint ventures with unrelated parties to develop luxury for-sale homes. At October 31, 2013, the Company had \$38.2 million of funding commitments to three of these joint ventures. One of the joint ventures expects to finance future construction with external financing.

In the first quarter of fiscal 2012, the Company entered into a joint venture in which it has a 50% interest to develop a high-rise luxury for-sale/rental project in the metro-New York market. At October 31, 2013, the Company had an investment of \$119.5 million and was committed to make additional investments of \$8.1 million in this joint venture. Under the terms of the agreement, upon completion of the construction of the building the Company will acquire ownership of the top 18 floors of the building to sell, for its own account, luxury condominium units and its partner will receive ownership of the lower floors containing residential rental units and retail space.

In the third quarter of fiscal 2012, the Company invested in a joint venture in which it has a 50% interest that will develop a high-rise luxury condominium project in the metro-New York market. At October 31, 2013, the Company had invested \$8.3 million in this joint venture. The Company expects to make additional investments of approximately \$21.8 million for the development of this property. The joint venture expects to borrow additional funds to complete the construction of this project. The Company has also guaranteed approximately \$7.4 million of payments related to the ground lease on this project.

Rental Joint Ventures

At October 31, 2013, the Company had an aggregate of \$68.7 million of investments in and advances to several joint ventures with unrelated parties to develop luxury for-rent apartments, commercial space and a hotel. At October 31, 2013, the Company had funding commitments to these joint ventures of \$27.9 million. At October 31, 2013, three of these joint ventures had aggregate loan commitments of \$193.8 million and outstanding borrowings against these commitments of \$14.4 million.

In the fourth quarter of fiscal 2013, the Company entered into a joint venture with an unrelated party to develop a luxury, 287-unit apartment building in the Capitol Riverfront of Washington, D.C. on land that the Company owned and conveyed to the joint venture. The Company has a 50% interest in this joint venture. As part of the Company's initial capital contribution, it contributed land and improvements with a fair value of \$27.1 million to the joint venture and subsequently received a cash distribution of \$12.5 million to align the capital accounts of each of the members of the joint venture. The joint venture entered into a \$54 million construction loan agreement with a bank to finance the development of this project. At October 31, 2013, the joint venture had no borrowings under the construction loan agreement. At October 31, 2013, the Company had an investment of \$14.7 million in this joint venture.

In the second quarter of fiscal 2013, the Company entered into a joint venture with an unrelated party to develop a luxury, 38-story apartment building and retail space in Jersey City, New Jersey on land that the Company owned and conveyed to the joint venture. The Company has a 50% interest in this joint venture. As part of the Company's initial capital contribution, it contributed land and improvements with a fair value of \$27.6 million to the joint venture and subsequently received cash distributions of \$10.6 million and a \$1.2 million cash payment by the joint venture on the Company's behalf to align the capital accounts of each of the members of the joint venture. The joint venture entered into a \$120 million construction loan agreement with a bank to finance the development of this project. At October 31, 2013, the joint venture had no borrowings under the construction loan agreement. At October 31, 2013, the Company had an investment of \$22.5 million in this joint venture and was committed to make additional contributions to this joint venture of up to \$8.0 million.

In the fourth quarter of fiscal 2012, the Company invested in a joint venture in which it has a 50% interest that will develop a multi-family residential apartment project containing approximately 398 units in suburban Philadelphia. At

October 31, 2013, the Company had an investment of \$15.6 million in this joint venture. The joint venture expects to borrow funds to complete the construction of this project. The Company does not have any additional commitment to fund this joint venture.

In the third quarter of fiscal 2012, the Company invested in a joint venture in which it has a 50% interest that will develop a luxury hotel in conjunction with a high-rise luxury condominium project in the metro-New York market. At October 31, 2013, the Company had invested \$4.9 million in this joint venture. The Company expects to make additional investments of approximately \$17.8 million for the development of this property. The joint venture expects to borrow additional funds to

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complete the construction of this project. The Company has also guaranteed approximately \$2.1 million of payments related to the ground lease on this project.

Structured Asset Joint Venture

In July 2010, the Company, through Gibraltar Capital and Asset Management LLC (“Gibraltar”), invested in a joint venture in which it is a 20% participant with two unrelated parties to purchase a 40% interest in an entity that owns and controls a portfolio of loans and real estate (“Structured Asset Joint Venture”). At October 31, 2013, the Company had an investment of \$25.7 million in this Structured Asset Joint Venture. At October 31, 2013, the Company did not have any commitments to make additional contributions to the joint venture and has not guaranteed any of the joint venture’s liabilities.

Toll Brothers Realty Trust and Toll Brothers Realty Trust II

In fiscal 2005, the Company, together with the Pennsylvania State Employees Retirement System (“PASERS”), formed Trust II to be in a position to invest in commercial real estate opportunities. Trust II is owned 50% by the Company and 50% by an affiliate of PASERS. At October 31, 2013, the Company had an investment of \$2.2 million in Trust II. In December 2013, Trust II sold substantially all of its assets to an unrelated party. See Note 1 - "Significant Accounting Policies - Subsequent Events" for more information.

Prior to the formation of Trust II, the Company formed the Trust in 1998 to invest in commercial real estate opportunities. The Trust is effectively owned one-third by the Company; one-third by Robert I. Toll, Bruce E. Toll (and members of his family), Douglas C. Yearley, Jr. and former members of the Company’s senior management; and one-third by an affiliate of PASERS (collectively, the “Shareholders”). As of October 31, 2013, the Company had a negative investment in the Trust of \$0.9 million resulting from a loss recognized by the Trust in the fourth quarter of fiscal 2013 due to the expensing of financing costs incurred in the refinancing of its debt. The Company expects that the Trust will return to profitability in fiscal 2014. The Company provides development, finance and management services to the Trust and recognized fees under the terms of various agreements in the amounts of \$4.2 million, \$2.7 million and \$2.9 million in fiscal 2013, 2012 and 2011, respectively.

Guarantees

The unconsolidated entities in which the Company has investments generally finance their activities with a combination of partner equity and debt financing. In some instances, the Company and its partners have guaranteed debt of certain unconsolidated entities which may include any or all of the following: (i) project completion including any cost overruns, in whole or in part, (ii) repayment guarantees, generally covering a percentage of the outstanding loan, (iii) indemnification of the lender as to environmental matters affecting the unconsolidated entity and (iv) indemnification of the lender from “bad boy acts” of the unconsolidated entity.

In some instances, the guarantees provided in connection with loans to an unconsolidated entity are joint and several. In these situations, the Company generally has a reimbursement agreement with its partner that provides that neither party is responsible for more than its proportionate share of the guarantee; however, if the joint venture partner does not have adequate financial resources to meet its obligations under the reimbursement agreement, the Company may be liable for more than its proportionate share.

The Company believes that as of October 31, 2013, in the event it becomes legally obligated to perform under a guarantee of the obligation of an unconsolidated entity due to a triggering event, the collateral should be sufficient to repay a significant portion of the obligation. If it is not, the Company and its partners would need to contribute additional capital to the venture. At October 31, 2013, the unconsolidated entities that have guarantees related to debt had loan commitments aggregating \$279.0 million and had borrowed an aggregate of \$65.7 million. The term of these guarantees generally range from 30 months to 48 months. The Company estimates that the maximum potential exposure under these guarantees, if the full amount of the loan commitments were borrowed, would be \$279.0 million before any reimbursement from the Company’s partners. Based on the amounts borrowed at October 31, 2013, the Company’s maximum potential exposure under these guarantees is estimated to be approximately \$65.7 million before any reimbursement from the Company’s partners.

In addition, the Company has guaranteed approximately \$11.6 million of ground lease payments and insurance deductibles for three joint ventures.

As of October 31, 2013, the estimated aggregate fair value of the guarantees was approximately \$1.6 million. The Company has not made payments under any of the guarantees, nor has it been called upon to do so.

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Variable Interest Entities

At October 31, 2013, the Company determined that three of its joint ventures were VIEs under the guidance within ASC 810. The Company has, however, concluded that it was not the primary beneficiary of the VIEs because the power to direct the activities of these VIEs that most significantly impact their performance was shared by the Company and the VIEs' other members. Business plans, budgets and other major decisions are required to be unanimously approved by all members. Management and other fees earned by the Company are nominal and believed to be at market rates and there is no significant economic disproportionality between the Company and other members.

The information presented below regarding the investments, commitments and guarantees in unconsolidated entities deemed to be VIEs is also included in the information provided above. At October 31, 2013 and 2012, the Company's investments in its unconsolidated joint ventures deemed to be VIEs, which are included in investments in and advances to unconsolidated entities in the accompanying balance sheets, totaled \$22.9 million and \$26.5 million, respectively. At October 31, 2013, the maximum exposure of loss to the Company's investments in unconsolidated joint ventures that are VIEs is limited to its investment in the unconsolidated VIEs, except with regard to \$41.7 million of additional commitments to the VIEs and a \$9.6 million guaranty of ground lease payments. At October 31, 2012, the maximum exposure to loss of the Company's investments in unconsolidated joint ventures that are VIEs was limited to its investment in the unconsolidated VIEs, except with regard to a \$47.7 million additional commitment to fund the joint ventures and a \$9.8 million guaranty of ground lease payments.

Joint Venture Condensed Financial Information

The condensed balance sheets, as of the dates indicated, and the condensed statements of operations, for the periods indicated, for the Company's unconsolidated entities in which it has an investment, aggregated by type of business, are included below (in thousands). The column titled "Rental Property Joint Ventures" includes the Rental Joint Ventures, the Trust and Trust II described above.

Condensed Balance Sheets:

	October 31, 2013				Total
	Develop- ment Joint Ventures	Home Building Joint Ventures	Rental Property Joint Ventures	Structured Asset Joint Venture	
Cash and cash equivalents	\$30,826	\$31,164	\$35,014	\$40,097	\$137,101
Inventory	350,150	338,814	4,998		693,962
Non-performing loan portfolio				107,411	107,411
Rental properties			164,325		164,325
Rental properties under development			133,081		133,081
Real estate owned ("REO")				202,259	202,259
Other assets (1)	12,700	70,180	18,526	155,921	257,327
Total assets	\$393,676	\$440,158	\$355,944	\$505,688	\$1,695,466
Debt (1)	135,200	11,977	235,226	155,900	538,303
Other liabilities	21,015	19,636	9,461	379	50,491
Members' equity	237,461	408,545	111,257	139,764	897,027
Noncontrolling interest				209,645	209,645
Total liabilities and equity	\$393,676	\$440,158	\$355,944	\$505,688	\$1,695,466
Company's net investment in unconsolidated entities (2)	\$142,448	\$166,271	\$68,711	\$25,703	\$403,133

	October 31, 2012				
	Develop- ment Joint Ventures	Home Building Joint Ventures	Rental Property Joint Ventures	Structured Asset Joint Venture	Total
Cash and cash equivalents	\$17,189	\$24,964	\$26,167	\$44,176	\$112,496
Inventory	255,561	251,030	5,643		512,234
Non-performing loan portfolio				226,315	226,315
Rental properties			173,767		173,767
Rental properties under development			43,695		43,695
Real estate owned (“REO”)				254,250	254,250
Other assets (1)	12,427	72,289	9,193	237,476	331,385
Total assets	\$285,177	\$348,283	\$258,465	\$762,217	\$1,654,142
Debt (1)	\$96,362	\$11,755	\$213,725	\$311,801	\$633,643
Other liabilities	14,390	9,438	5,534	561	29,923
Members’ equity	174,425	327,090	39,206	179,942	720,663
Noncontrolling interest				269,913	269,913
Total liabilities and equity	\$285,177	\$348,283	\$258,465	\$762,217	\$1,654,142
Company’s net investment in unconsolidated entities (2)	\$116,452	\$135,688	\$41,134	\$37,343	\$330,617

Included in other assets at October 31, 2013 and 2012 of the Structured Asset Joint Venture is \$155.9 million and (1) \$237.5 million, respectively, of restricted cash held in a defeasance account which will be used to repay debt of the Structured Asset Joint Venture.

Differences between the Company’s net investment in unconsolidated entities and its underlying equity in the net assets of the entities are primarily a result of the difference in the purchase price of a joint venture interest and its (2) underlying equity, impairments related to the Company’s investments in unconsolidated entities, a loan made to one of the entities by the Company, interest capitalized on the Company’s investment and distributions from entities in excess of the carrying amount of the Company’s net investment.

Condensed Statements of Operations:

	For the year ended October 31, 2013				
	Develop- ment Joint Ventures	Home Building Joint Ventures	Rental Property Joint Ventures	Structured Asset Joint Venture	Total
Revenues	\$43,937	\$40,386	\$38,727	\$37,492	\$160,542
Cost of revenues	20,142	36,208	16,704	30,496	103,550
Other expenses	1,146	2,554	20,875	3,399	27,974
Total expenses	21,288	38,762	37,579	33,895	131,524
Gain on disposition of loans and REO				68,323	68,323
Income from operations	22,649	1,624	1,148	71,920	97,341
Other income	11	571	86	329	997
Net income	22,660	2,195	1,234	72,249	98,338
Less: income attributable to noncontrolling interest				(43,349)	(43,349)
Net income attributable to controlling interest	22,660	2,195	1,234	28,900	54,989
Other comprehensive income			922		922

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Total comprehensive income	\$22,660	\$2,195	\$2,156	\$28,900	\$55,911
Company's equity in earnings of unconsolidated entities (3)	\$3,288	\$1,471	\$3,965	\$5,668	\$14,392

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	For the year ended October 31, 2012				
	Develop- ment Joint Ventures	Home Building Joint Ventures	Rental Property Joint Ventures	Structured Asset Joint Venture	Total
Revenues	\$39,278	\$89,947	\$37,035	\$31,686	\$197,946
Cost of revenues	36,315	65,068	13,985	32,828	148,196
Other expenses	1,414	3,477	21,226	8,646	34,763
Total expenses	37,729	68,545	35,211	41,474	182,959
Gain on disposition of loans and REO				42,244	42,244
Income from operations	1,549	21,402	1,824	32,456	57,231
Other income	2,658	153	4	691	3,506
Net income	4,207	21,555	1,828	33,147	60,737
Less: income attributable to noncontrolling interest				(19,888)	(19,888)
Net income attributable to controlling interest	4,207	21,555	1,828	13,259	40,849
Other comprehensive income					—
Total comprehensive income	\$4,207	\$21,555	\$1,828	\$13,259	\$40,849
Company's equity in earnings of unconsolidated entities (3)	\$3,995	\$15,303	\$1,602	\$2,692	\$23,592
	For the year ended October 31, 2011				
	Develop- ment Joint Ventures	Home Building Joint Ventures	Rental Property Joint Ventures	Structured Asset Joint Venture	Total
Revenues	\$4,624	\$242,326	\$37,728	\$46,187	\$330,865
Cost of revenues	3,996	191,922	15,365	30,477	241,760
Other expenses	1,527	6,988	20,774	10,624	39,913
Total expenses	5,523	198,910	36,139	41,101	281,673
Gain on disposition of loans and REO				61,406	61,406
Income from operations	(899)	43,416	1,589	66,492	110,598
Other income	9,498	68	1,537	252	11,355
Net income	8,599	43,484	3,126	66,744	121,953
Less: income attributable to noncontrolling interest				(40,048)	(40,048)
Net income attributable to controlling interest	8,599	43,484	3,126	26,696	81,905
Other comprehensive income					—
Total comprehensive income	\$8,599	\$43,484	\$3,126	\$26,696	\$81,905
Company's equity in earnings of unconsolidated entities (3)	\$(25,272)	\$14,895	\$3,844	\$5,339	\$(1,194)

(3) Differences between the Company's equity in earnings (losses) of unconsolidated entities and the underlying net income of the entities are primarily a result of impairments related to the Company's investments in unconsolidated entities, distributions from entities in excess of the carrying amount of the Company's net investment and the

Company's share of the entities profits related to home sites purchased by the Company that reduces the Company's cost basis of the home sites.

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5. Investments in Distressed Loans and Foreclosed Real Estate

Investments in Distressed Loans

The Company's investment in distressed loans consisted of the following at October 31, 2013 and 2012 (amounts in thousands):

	2013	2012
Unpaid principal balance	\$63,381	\$99,693
Discount on acquired loans	(27,007	) (62,524
Carrying value	\$36,374	\$37,169

The Company's investment in distressed loans includes performing loans and non-performing loans and also includes investments in loan participations classified as secured borrowings under ASC 860, "Transfers and Servicing."

For acquired distressed loans where it is probable that the Company will collect less than the contractual amounts due under the terms of the loan based, at least in part, on the assessment of the credit quality of the borrowers, the loans are accounted for under ASC 310-30. Under ASC 310-30, provided the Company does not presently have the intention to utilize real estate secured by the loans for use in its operations or to significantly improve the collateral for resale, the amount by which the future cash flows expected to be collected at the acquisition date exceeds the estimated fair value of the loan, or accretable yield, is recognized in other income - net over the estimated remaining life of the loan using a level yield methodology. The difference between the contractually required payments of the loan as of the acquisition date and the total cash flows expected to be collected, or nonaccretable difference, is not recognized.

The Company may acquire distressed loans where it has determined that (1) it is possible to collect all contractual amounts due under the terms of the loan, (2) it expects to utilize the real estate secured by the loans in its operations, or (3) forecasted cash flows cannot be reasonably estimated. For non-performing loans acquired meeting any of these conditions, in accordance with ASC 310-10, "Receivable," ("ASC 310-10") the loans are classified as nonaccrual and interest income is not recognized. When a loan is classified as non-accrual, any subsequent cash receipt is accounted for using the cost recovery method. For performing loans, payments are applied to principal and interest in accordance with the terms of the loan when received. As of October 31, 2013, the Company had investments in performing and non-performing loans, accounted for in accordance with ASC 310-10, of \$0.8 million and \$21.4 million, respectively. At October 31, 2012, the Company had investments in non-performing loans, accounted for in accordance with ASC 310-10, of \$9.2 million. The Company had no investments in performing loans at October 31, 2012.

For the year ended October 31, 2013, the Company, through Gibraltar purchased distressed loans for approximately \$26.0 million. The purchases included performing and non-performing loans secured by retail shopping centers, residential land and golf courses located in seven states.

The following table summarizes, for the distressed loans acquired in fiscal 2012 that were accounted for in accordance with ASC 310-30, the accretable yield and the nonaccretable difference of the Company's investment in these loans as of their acquisition date (amounts in thousands).

	2012
Contractually required payments, including interest	\$58,234
Non-accretable difference	(8,235
Cash flows expected to be collected	) 49,999
Accretable yield	(20,514
Distressed loans carrying amount	) \$29,485

There were no distressed loans purchased during the year ended October 31, 2013 that met the requirements of ASC 310-30.

The accretable yield activity for the Company's investment in distressed loans accounted for under ASC 310-30 for the years ended October 31, 2013 and 2012 was as follows (amounts in thousands):

	2013	2012
Balance, beginning of period	\$17,196	\$42,326
Loans acquired		20,514
Additions	1,654	5,539
Deletions	(7,728)	(40,227)
Accretion	(4,516)	(10,956)
Balance, end of period	\$6,606	\$17,196

Additions primarily represent the reclassification to accretable yield from nonaccretable yield and the impact of impairments. Deletions primarily represent loan dispositions, which include foreclosure of the underlying collateral and resulting removal of the loans from the accretable yield portfolios, and reclassifications from accretable yield to nonaccretable yield. The reclassifications between accretable and nonaccretable yield and the accretion of interest income are based on various estimates regarding loan performance and the value of the underlying real estate securing the loans. As the Company continues to gather additional information regarding the loans and the underlying collateral, the accretable yield may change. Therefore, the amount of accretable income recorded in the years ended October 31, 2013 and 2012 is not necessarily indicative of future results.

Foreclosed Real Estate Owned

The following table presents the activity in REO at October 31, 2013, 2012 and 2011 (amounts in thousands):

	2013	2012	2011
Balance, beginning of period	\$58,353	\$5,939	\$—
Additions	23,470	54,174	5,939
Sales	(7,842)	(1,353)	
Impairments	(505)	(126)	
Depreciation	(504)	(281)	
Balance, end of period	\$72,972	\$58,353	\$5,939

As of October 31, 2013, approximately \$7.6 million and \$65.3 million of REO was classified as held-for-sale and held-and-used, respectively. As of October 31, 2012, approximately \$5.9 million and \$52.4 million of REO was classified as held-for-sale and held-and-used, respectively. For the years ended October 31, 2013 and October 31, 2012, the Company recorded gains of \$3.6 million and \$0.6 million from acquisitions of REO through foreclosure, respectively.

General

The Company's earnings from Gibraltar's operations, excluding its investment in the Structured Asset Joint Venture, are included in other income - net in its Condensed Consolidated Statements of Operations. In the years ended October 31, 2013 and 2012, the Company recognized \$10.2 million and \$4.5 million of earnings (excluding earnings from its investment in the Structured Asset Joint Venture), respectively, from Gibraltar's operations.

6. Credit Facility, Loans Payable, Senior Notes and Mortgage Company Warehouse Loan

Credit Facility

On August 1, 2013, the Company entered into a \$1.04 billion ("Aggregate Credit Commitment") unsecured, five-year credit facility ("Credit Facility") with 15 banks which extends to August 1, 2018. Up to 75% of the Aggregate Credit Commitment is available for letters of credit. The Credit Facility has an accordion feature under which the Company may, subject to certain conditions set forth in the agreement, increase the Credit Facility up to a maximum aggregate amount of \$2.0 billion. The Company may select interest rates for the Credit Facility equal to (i) LIBOR plus an applicable margin or (ii) the lenders' base rate plus an applicable margin, which in each case is based on the Company's credit rating and leverage ratio. The Company is obligated to pay an undrawn commitment fee which is based on the average daily unused amount of the Aggregate Credit Commitment and the Company's credit ratings and leverage ratio. Any proceeds from borrowings under the Credit Facility may be used for general corporate purposes.

Under the terms of the Credit Facility, the Company is not permitted to allow its maximum leverage ratio (as defined in the Credit Agreement) to exceed 1.75 to 1.00 and is required to maintain a minimum tangible net worth (as defined in the Credit Facility) of no less than approximately \$2.28 billion. Under the terms of the Credit Agreement, at October 31, 2013, the Company's leverage ratio was approximately 0.49 to 1.00 and its tangible net worth was approximately \$3.28 billion. Based upon the minimum tangible net worth requirement at October 31, 2013, the Company's ability to pay dividends would have been limited to an aggregate amount of approximately \$1.0 billion or the repurchase of our common stock of approximately \$1.49 billion.

The Credit Facility replaced the Company's revolving credit facility entered into as of October 22, 2010 (the "2010 Facility"). Upon entering into the Credit Facility, the Company voluntarily terminated the 2010 Facility on August 1, 2013. No early termination penalties were incurred by the Company as a result of the termination of the 2010 Facility. At October 31, 2013, the Company had no outstanding borrowings under the Credit Facility but had outstanding letters of credit of approximately \$76.6 million.

Loans Payable

The Company's loans payable represent purchase money mortgages on properties the Company has acquired that the seller has financed and various revenue bonds that were issued by government entities on behalf of the Company to finance community infrastructure and the Company's manufacturing facilities. Information regarding the Company's loans payable at October 31, 2013 and 2012 is included in the table below (\$ amounts in thousands).

	2013		2012	
Aggregate loans payable at October 31	\$107,222		\$99,817	
Weighted-average interest rate	4.53	%	3.64	%
Interest rate range	0.14% - 7.87%		0.26% - 7.87%	
Loans secured by assets				
Carrying value of loans secured by assets	\$106,358		\$98,952	
Carrying value of assets securing loans	\$372,833		\$311,104	

The contractual maturities of loans payable as of October 31, 2013 ranged from less than 1 month to 22 years.

Senior Notes

At October 31, 2013 and 2012, the Company's senior notes consisted of the following (amounts in thousands):

	2013		2012	
6.875% Senior Notes due November 15, 2012			\$59,068	
5.95% Senior Notes due September 15, 2013			104,785	
4.95% Senior Notes due March 15, 2014	\$267,960		267,960	
5.15% Senior Notes due May 15, 2015	300,000		300,000	
8.91% Senior Notes due October 15, 2017	400,000		400,000	
6.75% Senior Notes due November 1, 2019	250,000		250,000	
5.875% Senior Notes due February 15, 2022	419,876		419,876	
0.5% Exchangeable Senior Notes due September 15, 2032	287,500		287,500	
4.375% Senior Notes due April 15, 2023	400,000			
Bond discount	(3,894	)	(8,726)
	\$2,321,442		\$2,080,463	

The senior notes are the unsecured obligations of Toll Brothers Finance Corp., a 100%-owned subsidiary of the Company. The payment of principal and interest is fully and unconditionally guaranteed, jointly and severally, by the Company and a majority of its home building subsidiaries (together with Toll Brothers Finance Corp., the "Senior Note Parties"). The senior notes rank equally in right of payment with all the Senior Note Parties' existing and future unsecured senior indebtedness, including the Credit Facility. The senior notes are structurally subordinated to the prior claims of creditors, including trade creditors, of the subsidiaries of the Company that are not guarantors of the senior notes. The senior notes, other than the 0.5% Exchangeable Senior Notes due 2032 ("0.5% Senior Notes"), are redeemable in whole or in part at any time at the option of the Company, at

prices that vary based upon the then-current rates of interest and the remaining original term of the notes. The 0.5% Senior Notes are not redeemable by the Company prior to September 15, 2017.

In September 2013, the Company repaid the outstanding \$104.8 million of its 5.95% Senior Notes due September 15, 2013.

On April 3, 2013, the Company, through Toll Brothers Finance Corp., issued \$300.0 million principal amount of 4.375% Senior Notes due 2023 (the "4.375% Senior Notes") at par. The Company received \$298.1 million of net proceeds from this issuance of 4.375% Senior Notes.

On May 13, 2013, the Company, through Toll Brothers Finance Corp., issued an additional \$100.0 million principal amount of 4.375% Senior Notes at a price equal to 103% of par value. The Company received \$102.3 million of net proceeds from this additional issuance of 4.375% Senior Notes.

In November 2012, the Company repaid the \$59.1 million of outstanding 6.875% Senior Notes due November 15, 2012.

In September 2012, the Company, through Toll Brothers Finance Corp., issued \$287.5 million principal amount of 0.5% Senior Notes. The Company received \$282.5 million of net proceeds from the issuance of the 0.5% Senior Notes. The 0.5% Senior Notes are exchangeable into shares of the Company's common stock at an exchange rate of 20.3749 shares per \$1,000 principal amount of notes, corresponding to an initial exchange price of approximately \$49.08 per share of the Company's common stock. If all of the 0.5% Senior Notes are exchanged, the Company would issue approximately 5.9 million shares of its common stock. Shares issuable upon conversion of the 0.5% Senior Notes are included in the calculation of diluted earnings per share. See Note 11, "Income Per Share Information" for more information regarding the number of shares included in the calculation of diluted earnings per share. Holders of the 0.5% Senior Notes will have the right to require Toll Brothers Finance Corp. to repurchase their notes for cash equal to 100% of their principal amount, plus accrued but unpaid interest, on each of December 15, 2017, September 15, 2022 and September 15, 2027. Toll Brothers Finance Corp. will have the right to redeem the 0.5% Senior Notes on or after September 15, 2017 for cash equal to 100% of their principal amount, plus accrued but unpaid interest.

In February 2012, the Company, through Toll Brothers Finance Corp., issued \$300 million principal amount of 5.875% Senior Notes due 2022 (the "5.875% Senior Notes"). The Company received \$296.2 million of net proceeds from the issuance of the 5.875% Senior Notes. In March 2012, the Company, through Toll Brothers Finance Corp., issued an additional \$119.9 million principal amount of its 5.875% Senior Notes in exchange for \$80.7 million principal amount of its 6.875% Senior Notes due 2012 and \$36.9 million principal amount of its 5.95% Senior Notes due 2013. The Company recognized a charge of \$1.2 million in fiscal 2012 representing the aggregate costs associated with the exchange of both series of notes; these expenses are included in selling, general and administrative expenses in the Consolidated Statement of Operations.

The Company repurchased \$55.1 million of its 6.875% Senior Notes due 2012 in fiscal 2011 and \$45.5 million (\$13.5 million of its 5.95% Senior notes due 2013 and \$32.0 million of its 4.95% Senior Notes due 2014) of its senior notes in fiscal 2010. In fiscal 2011 and 2010, the Company recognized \$3.8 million and \$1.2 million, respectively, of expenses related to the retirement of these notes. Expenses related to the retirement of notes include, if any, premium paid, write-off of unamortized debt issuance costs and other debt redemption costs.

In November 2013, the Company issued \$600 million of senior notes. See Note 1 - "Significant Accounting Policies - Subsequent Events" for more information.

Mortgage Company Loan Facility

TBI Mortgage Company ("TBI Mortgage"), the Company's wholly-owned mortgage subsidiary, has a Master Repurchase Agreement (the "Repurchase Agreement") with Comerica Bank. The purpose of the Repurchase Agreement is to finance the origination of mortgage loans by TBI Mortgage and it is accounted for as a secured borrowing under ASC 860. The Repurchase Agreement, as amended, provides for loan purchases up to \$50 million, subject to certain sublimits. In addition, the Repurchase Agreement provides for an accordion feature under which TBI Mortgage may request that the aggregate commitments under the Repurchase Agreement be increased to an amount up to \$75 million for a short period of time. The Repurchase Agreement, as amended, expires on July 22, 2014 and bears interest at LIBOR plus 2.00%, with a minimum rate of 3.00%. Borrowings under this facility are included in the fiscal 2013

maturities.

At October 31, 2013 and 2012, there were \$75.0 million and \$72.7 million, respectively, outstanding under the Repurchase Agreement, which are included in liabilities in the accompanying Consolidated Balance Sheets. At October 31, 2013 and 2012, amounts outstanding under the Repurchase Agreement were collateralized by \$113.5 million and \$86.4 million, respectively, of mortgage loans held for sale, which are included in assets in the Company's Consolidated Balance Sheets. As of October 31, 2013, there were no aggregate outstanding purchase price limitations reducing the amount available to TBI Mortgage. There are

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several restrictions on purchased loans under the Repurchase Agreement, including that they cannot be sold to others, they cannot be pledged to anyone other than the agent and they cannot support any other borrowing or repurchase agreement.

General

As of October 31, 2013, the annual aggregate maturities of the Company's loans and notes during each of the next five fiscal years are as follows (amounts in thousands):

	Amount
2014	373,049
2015	317,365
2016	9,332
2017	404,415
2018	1,989

7. Accrued Expenses

Accrued expenses at October 31, 2013 and 2012 consisted of the following (amounts in thousands):

	2013	2012
Land, land development and construction	\$152,674	\$124,731
Compensation and employee benefit	111,561	111,093
Insurance and litigation	89,104	101,908
Warranty	43,819	41,706
Interest	25,675	28,204
Commitments to unconsolidated entities	3,804	2,135
Other	96,350	66,573
	\$522,987	\$476,350

The Company accrues for expected warranty costs at the time each home is closed and title and possession are transferred to the home buyer. Warranty costs are accrued based upon historical experience. The table below provides a reconciliation of the changes in the Company's warranty accrual during fiscal 2013, 2012 and 2011 as follows (amounts in thousands):

	2013	2012	2011
Balance, beginning of year	\$41,706	\$42,474	\$45,835
Additions - homes closed during the year	14,652	10,560	8,809
Addition - liabilities acquired		731	
(Decrease) increase in accruals for homes closed in prior years	(184	) 479	(828)
Charges incurred	(12,355	) (12,538	) (11,342)
Balance, end of year	\$43,819	\$41,706	\$42,474

8. Income Taxes

The following table provides a reconciliation of the Company's effective tax rate from the federal statutory tax rate for the fiscal years ended October 31, 2013, 2012 and 2011 (\$ amounts in thousands).

	2013		2012		2011	
	\$	%*	\$	%*	\$	%*
Federal tax provision (benefit) at statutory rate	93,694	35.0	39,530	35.0	(10,278)	35.0
State tax provision (benefit), net of federal benefit	11,363	4.2	4,711	4.2	(954)	3.2
Reversal of accrual for uncertain tax positions	(5,580)	(2.1)	(34,167)	(30.3)	(52,306)	178.1
Accrued interest on anticipated tax assessments	3,704	1.4	5,000	4.4	3,055	(10.4)
Increase in unrecognized tax benefits		—	5,489	4.9		—
Increase in deferred tax assets, net	(4,914)	(1.8)		—	(25,948)	88.4
Valuation allowance — recognized	3,232	1.2		—	43,876	(149.4)
Valuation allowance — reversed	(4,569)	(1.7)	(394,718)	(349.5)	(25,689)	87.5
Other	161	0.1	(49)	—	(917)	3.1
Income tax provision (benefit)*	97,091	36.3	(374,204)	(331.3)	(69,161)	235.5

* Due to rounding, amounts may not add.

The Company currently operates in 19 states and is subject to various state tax jurisdictions. The Company estimates its state tax liability based upon the individual taxing authorities' regulations, estimates of income by taxing jurisdiction and the Company's ability to utilize certain tax-saving strategies. Based on the Company's estimate of the allocation of income or loss among the various taxing jurisdictions and changes in tax regulations and their impact on the Company's tax strategies, the Company estimated its rate for state income taxes at 6.5%, 6.5% and 5.0% in fiscal 2013, 2012 and 2011.

The following table provides information regarding the provision (benefit) for income taxes for each of the fiscal years ended October 31, 2013, 2012 and 2011 (amounts in thousands).

	2013	2012	2011
Federal	\$93,451	\$(329,277)	\$(21,517)
State	3,640	(44,927)	(47,644)
	\$97,091	\$(374,204)	\$(69,161)
Current	\$23,209	\$(21,296)	\$(43,212)
Deferred	73,882	(352,908)	(25,949)
	\$97,091	\$(374,204)	\$(69,161)

In November 2009, the Worker, Homeownership, and Business Assistance Act of 2009 was enacted into law which allowed the Company to carry back its fiscal 2010 taxable loss against taxable income reported in fiscal 2006 and receive a federal tax refund in its second quarter of fiscal 2011 of \$154.3 million. The tax losses generated in fiscal 2010 were primarily from the recognition for tax purposes of previously recognized book impairments and the recognition of stock option expenses recognized for book purposes in prior years.

The following table provides a reconciliation of the change in the unrecognized tax benefits for the years ended October 31, 2013, 2012 and 2011 (amounts in thousands).

	2013	2012	2011
Balance, beginning of year	\$80,991	\$104,669	\$160,446
Increase in benefit as a result of tax positions taken in prior years	5,699	5,000	8,168
Increase in benefit as a result of tax positions taken in current year		5,489	
Decrease in benefit as a result of settlements			(17,954)
Decrease in benefit as a result of completion of audits		(1,782)	(33,370)
Decrease in benefit as a result of lapse of statute of limitation	(8,585)	(32,385)	(12,621)
Balance, end of year	\$78,105	\$80,991	\$104,669

The statute of limitation has expired on the Company's federal tax returns for fiscal years through 2009.

The Company's unrecognized tax benefits are included in "Income taxes payable" on the Company's consolidated balance sheets. If these unrecognized tax benefits reverse in the future, they would have a beneficial impact on the Company's effective tax rate at that time. During the next twelve months, it is reasonably possible that the amount of unrecognized tax benefits will change but we are not able to provide a range of such change. The anticipated changes will be principally due to the expiration of tax statutes, settlements with taxing jurisdictions, increases due to new tax positions taken and the accrual of estimated interest and penalties.

The Company recognizes in its tax provision (benefit), potential interest and penalties. The following table provides information as to the amounts recognized in its tax provision (benefit), before reduction for applicable taxes and reversal of previously accrued interest and penalties, of potential interest and penalties in the twelve-month periods ended October 31, 2013, 2012 and 2011, and the amounts accrued for potential interest and penalties at October 31, 2013 and 2012 (amounts in thousands).

Expense recognized in statements of operations

Fiscal year

2013	\$5,699
2012	\$5,000
2011	\$4,700

Accrued at:

October 31, 2013	\$28,362
October 31, 2012	\$24,906

The amounts accrued for interest and penalties are included in "Income taxes payable" on the Company's consolidated balance sheets.

The components of net deferred tax assets and liabilities at October 31, 2013 and 2012 are set forth below (amounts in thousands).

	2013	2012
Deferred tax assets:		
Accrued expenses	\$53,992	\$56,598
Impairment charges	262,346	319,818
Inventory valuation differences	28,448	30,424
Stock-based compensation expense	48,014	44,336
Amounts related to unrecognized tax benefits	35,603	36,934
State tax, net operating loss carryforward	55,763	50,006
Federal tax net operating loss carryforward		25,170
Other	20,369	21,345
Total assets	504,535	584,631
Deferred tax liabilities:		
Capitalized interest	100,514	102,713
Deferred income	7,388	7,784
Expenses taken for tax purposes not for book	29,257	36,811
Depreciation	4,548	3,994
Deferred marketing	21,089	18,229
Total liabilities	162,796	169,531
Net deferred tax assets before valuation allowances	341,739	415,100
Cumulative valuation allowance - state	(55,707)	(57,044)
Net deferred tax assets	\$286,032	\$358,056

As of October 31, 2012, the Company reclassified \$1.1 million of deferred tax assets from accrued expenses to inventory valuation differences and \$1.2 million of deferred tax liabilities from other to deferred income. These amounts were reclassified to conform to the fiscal 2013 presentation.

Since the beginning of fiscal 2007, the Company recorded significant deferred tax assets as a result of the recognition of inventory impairments and impairments of investments in and advances to unconsolidated entities. In accordance with GAAP, the Company assessed whether a valuation allowance should be established based on its determination of whether it is “more likely than not” that some portion or all of the deferred tax assets would not be realized. In fiscal 2009, the Company recorded valuation allowances against its deferred tax assets due to its belief that the continued downturn in the housing market, the uncertainty as to its length and magnitude, the Company's continued recognition of impairment charges, and its operating losses were significant negative evidence of the need for a valuation allowance against its net deferred tax assets.

At October 31, 2012, the Company considered the need for a valuation allowance against its deferred tax assets considering all available and objectively verifiable positive and negative evidence. That evidence principally consisted of (i) an indication that the events and conditions that gave rise to significant losses in prior years were unlikely to recur in the foreseeable future, (ii) a return to profitability in fiscal 2012 together with expectations of continuing profitability in fiscal 2013, supported by existing backlog, and beyond, and (iii) the term of the statutory operating loss carry-forward periods provide evidence that it is more likely than not that these deferred tax assets will be realized. At October 31, 2012, the Company determined that the valuation allowance on its federal deferred tax assets and certain state valuation allowances were no longer needed. Accordingly, in fiscal 2012, the Company reversed a valuation allowance in the amount of \$394.7 million; this has been reported as a component of income tax provision (benefit) in the accompanying Consolidated Statements of Operations. During fiscal 2013, the Company continued to re-evaluate the need for its remaining state valuation allowance and updated its fiscal 2012 analysis. Based upon the Company's better than forecasted operating results in fiscal 2013, its significantly higher backlog at October 31, 2013 and

improved forecast of results of operations in fiscal 2014, it reversed an additional \$4.6 million of state deferred tax asset valuation allowance in fiscal 2013. The Company will continue to review its deferred tax assets in accordance with ASC 740. The remaining valuation allowance at October 31, 2013 of \$55.7 million relates to deferred tax assets in states that had not met the “more-likely-than-not” realization threshold criteria.

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At October 31, 2013, the Company expects to utilize all prior year federal tax loss carryforwards resulting from losses incurred for federal income tax purposes during fiscal years 2011 and 2012 on its fiscal 2013 federal income tax return.

We file tax returns in the various states in which we do business. Each state has its own statutes regarding the use of tax loss carryforwards. Some of the states in which we do business do not allow for the carryforward of losses while others allow for carryforwards for 5 years to 20 years.

9. Stockholders' Equity

The Company's authorized capital stock consists of 400 million shares of common stock, \$.01 par value per share and 15 million shares of preferred stock, \$.01 par value per share. At October 31, 2013, the Company had 169.4 million shares of common stock issued and outstanding, 11.0 million shares of common stock reserved for outstanding stock options and restricted stock units, 4.4 million shares of common stock reserved for future stock option and award issuances, 5.9 million shares of common stock reserved for the conversion of its 0.5% senior notes and 0.6 million shares of common stock reserved for issuance under the Company's employee stock purchase plan. As of October 31, 2013, the Company had issued no shares of preferred stock.

In November 2013, the Company issued 7.2 million shares of its common stock in a public offering. See Note 1 - "Significant Accounting Policies - Subsequent Events" for more information.

Issuance of Restricted Common Stock

In fiscal 2012 and 2011, the Company issued 1,350 and 1,250 shares of restricted common stock, respectively, pursuant to its stock incentive plans to certain outside directors. The Company is amortizing the fair market value of the awards on the date of grant over the period of time that each award vests. At October 31, 2013, 675 shares of the restricted stock awards were unvested.

Stock Repurchase Program

In March 2003, the Company's Board of Directors authorized the repurchase of up to 20 million shares of its common stock from time to time, in open market transactions or otherwise, for the purpose of providing shares for its various benefit plans.

The following table provides information about the Company's share repurchase program for the fiscal years ended October 31, 2013, 2012 and 2011.

	2013	2012	2011
Number of shares purchased (in thousands)	498	20	3,068
Average price per share	\$30.90	\$25.62	\$16.00
Remaining authorization at October 31 (in thousands)	8,268	8,766	8,786

Stockholder Rights Plan and Transfer Restriction

In June 2007, the Company adopted a shareholder rights plan ("2007 Rights Plan"). The rights issued pursuant to the 2007 Rights Plan will become exercisable upon the earlier of (i) ten days following a public announcement that a person or group of affiliated or associated persons has acquired, or obtained the right to acquire, beneficial ownership of 15% or more of the outstanding shares of the Company's common stock or (ii) ten business days following the commencement of a tender offer or exchange offer that would result in a person or group beneficially owning 15% or more of the outstanding shares of common stock. No rights were exercisable at October 31, 2013.

On March 17, 2010, the Board of Directors of the Company adopted a Certificate of Amendment to the Second Restated Certificate of Incorporation of the Company (the "Certificate of Amendment"). The Certificate of Amendment includes an amendment approved by the Company's stockholders at the 2010 Annual Meeting of Stockholders that restricts certain transfers of the Company's common stock in order to preserve the tax treatment of the Company's net operating and unrealized tax losses. The Certificate of Amendment's transfer restrictions generally restrict any direct or indirect transfer of the Company's common stock if the effect would be to increase the direct or indirect ownership of any Person (as defined in the Certificate of Amendment) from less than 4.95% to 4.95% or more of the Company's common stock or increase the ownership percentage of a person owning or deemed to own 4.95% or more of the Company's common stock. Any direct or indirect transfer attempted in violation of this restriction would be void as of the date of the prohibited transfer as to the purported transferee.

10. Stock-Based Benefit Plans

The Company has two active stock incentive plans, one for employees (including officers) and one for non-employee directors. The Company's active stock incentive plans provide for the granting of incentive stock options (solely to employees) and non-qualified stock options with a term of up to ten years at a price not less than the market price of the stock at the date of grant. The Company's active stock incentive plans also provide for the issuance of stock appreciation rights and restricted and unrestricted stock awards and stock units, which may be performance-based. The Company grants stock options, restricted stock and various types of restricted stock units to its employees and its non-employee directors under its stock incentive plans. Beginning in fiscal 2012, the Company changed the mix of stock-based compensation to its employees by reducing the number of stock options it grants and, in their place, issued non-performance-based restricted stock units as a form of compensation. At October 31, 2013, 2012 and 2011, the Company had 4,397,000, 5,489,000 and 6,712,000 shares, respectively, available for grant under its stock incentive plans.

The Company has one additional stock incentive plan for employees, officers and directors that is inactive except for outstanding stock option awards at October 31, 2013. No additional options may be granted under this plan. Stock options granted under this plan were made with a term of up to ten years at a price not less than the market price of the stock at the date of grant and generally vested over a four-year period for employees and a two-year period for non-employee directors.

The following table provides information regarding the amount of total stock-based compensation expense recognized by the Company for fiscal 2013, 2012 and 2011 (amounts in thousands):

	2013	2012	2011
Total stock-based compensation expense recognized	\$19,041	\$15,575	\$12,548
Income tax benefit recognized	\$7,378	\$5,711	\$4,793

At October 31, 2013, 2012 and 2011, the aggregate unamortized value of outstanding stock-based compensation awards was approximately \$19.9 million, \$14.2 million and \$12.7 million, respectively.

Information about the Company's more significant stock-based compensation programs is outlined below.

Stock Options:

Stock options granted to employees generally vest over a four-year period, although certain grants may vest over a longer or shorter period, and stock options granted to non-employee directors generally vest over a two-year period. Shares issued upon the exercise of a stock option are either from shares held in treasury or newly issued shares. The fair value of each option award is estimated on the date of grant using a lattice-based option valuation model that uses assumptions noted in the following table. Expected volatilities were based on implied volatilities from traded options on the Company's stock, historical volatility of the Company's stock and other factors. The expected lives of options granted were derived from the historical exercise patterns and anticipated future patterns and represent the period of time that options granted are expected to be outstanding; the range given below results from certain groups of employees exhibiting different behaviors. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

The following table summarizes the weighted-average assumptions and fair value used for stock option grants in each of the fiscal years ended October 31, 2013, 2012 and 2011.

	2013	2012	2011
Expected volatility	44.04% - 48.13%	44.20% - 50.24%	45.38% - 49.46%
Weighted-average volatility	46.70%	46.99%	47.73%
Risk-free interest rate	0.64% - 1.56%	0.78% - 1.77%	1.64% - 3.09%
Expected life (years)	4.48 - 8.88	4.59 - 9.06	4.29 - 8.75
Dividends	none	none	none
Weighted-average fair value per share of options granted	\$13.05	\$8.70	\$7.94

The fair value of stock option grants is recognized evenly over the vesting period of the options or over the period between the grant date and the time the option becomes non-forfeitable by the employee, whichever is shorter. Information regarding the stock compensation expense, related to stock options, for fiscal 2013, 2012 and 2011 was as follows (amounts in thousands):

	2013	2012	2011
Stock compensation expense recognized - options	\$7,703	\$7,411	\$8,626

At October 31, 2013, total compensation cost related to non-vested stock option awards not yet recognized was approximately \$9.8 million and the weighted-average period over which the Company expects to recognize such compensation costs and tax benefit is approximately 2.6 years.

The following table summarizes stock option activity for the Company's plans during each of the fiscal years ended October 31, 2013, 2012 and 2011 (amounts in thousands, except per share amounts):

	2013		2012		2011	
	Number of options	Weighted-average exercise price	Number of options	Weighted-average exercise price	Number of options	Weighted-average exercise price
Balance, beginning	10,669	\$23.23	12,868	\$20.94	14,339	\$19.36
Granted	768	32.22	777	20.50	1,103	19.32
Exercised	(1,454)	19.21	(2,941)	12.52	(2,467)	11.07
Canceled	(59)	25.09	(35)	20.67	(107)	20.12
Balance, ending	9,924	\$24.51	10,669	\$23.23	12,868	\$20.94
Options exercisable, at October 31,	7,996	\$24.49	8,540	\$24.09	10,365	\$21.24

The weighted average remaining contractual life (in years) for options outstanding and exercisable at October 31, 2013 was 4.3 and 3.4, respectively.

The intrinsic value of options outstanding and exercisable is the difference between the fair market value of the Company's common stock on the applicable date ("Measurement Value") and the exercise price of those options that had an exercise price that was less than the Measurement Value. The intrinsic value of options exercised is the difference between the fair market value of the Company's common stock on the date of exercise and the exercise price.

The following table provides information pertaining to the intrinsic value of options outstanding and exercisable at October 31, 2013, 2012 and 2011 (amounts in thousands):

	2013	2012	2011
Intrinsic value of options outstanding	\$84,938	\$106,084	\$16,839
Intrinsic value of options exercisable	\$68,920	\$77,936	\$16,839

Information pertaining to the intrinsic value of options exercised and the fair value of options that became vested or modified in each of the fiscal years ended October 31, 2013, 2012 and 2011 is provided below (amounts in thousands):

	2013	2012	2011
Intrinsic value of options exercised	\$19,632	\$39,730	\$23,573
Fair value of options vested	\$8,334	\$10,079	\$11,027

The Company's stock incentive plans permit optionees to exercise stock options using a "net exercise" method at the discretion of the Executive Compensation Committee of the Board of Directors ("Executive Compensation Committee"). In a net exercise, the Company withholds from the total number of shares that otherwise would be issued to an optionee upon exercise of the stock option that number of shares having a fair market value at the time of exercise equal to the option exercise price and applicable income tax withholdings and remits the remaining shares to the optionee.

The following table provides information regarding the use of the net exercise method for fiscal 2013, 2012 and 2011.

	2013	2012	2011
Options exercised	531,000	303,412	194,000
Shares withheld	405,838	151,889	98,918
Shares issued	125,162	151,523	95,082
Average market value per share withheld	\$32.22	\$22.68	\$18.94
Aggregate market value of shares withheld (in thousands)	\$13,076	\$3,445	\$1,873

In addition, pursuant to the provisions of the Company's stock incentive plans, optionees are permitted to use the value of the Company's common stock that they own to pay for the exercise of options ("stock swap method").

The following table provides information regarding the use of the stock swap method for fiscal 2013, 2012 and 2011.

	2013	2012	2011
Options exercised	6,534	19,686	28,900
Shares tendered	4,034	8,224	14,807
Shares issued	2,500	11,462	14,093
Average market value per share withheld	\$32.61	\$25.52	\$20.53
Aggregate market value of shares tendered (in thousands)	\$132	\$210	\$304

Performance Based Restricted Stock Units:

In fiscal 2013 and 2012, the Executive Compensation Committee approved awards of performance-based restricted stock units ("Performance-Based RSUs") relating to shares of the Company's common stock to certain of its senior management. The use of Performance-Based RSUs replaced the use of stock price-based restricted stock units awarded in prior years. The Performance-Based RSUs are based on the attainment of certain performance metrics of the Company in year of grant. The number of shares underlying the Performance-Based RSUs that will be issued to the recipients may range from 90% to 110% of the base award depending on actual performance metrics as compared to the target performance metrics. The Performance-Based RSUs vest over a four-year period provided the recipients continue to be employed by the Company or serve on the Board of Directors of the Company (as applicable) as specified in the award document.

The value of the Performance-Based RSUs was determined to be equal to the estimated number of shares of the Company's common stock to be issued multiplied by the closing price of the Company's common stock on the New York Stock Exchange ("NYSE") on the date the Performance-Based RSU awards were approved by the Executive Compensation Committee. The Company evaluates the performance-based metrics quarterly and estimates the number of shares underlying the RSUs that are probable of being issued. The following table provides information regarding the issuance, valuation assumptions and amortization of the Company's Performance-Based RSUs issued in fiscal 2013 and 2012.

	2013	2012
Number of shares underlying Performance-Based RSUs to be issued	302,511	370,176
Closing price of the Company's common stock on date performance goals were approved	\$37.78	\$20.50
Estimated aggregate fair value of Performance-Based RSUs issued (in thousands)	\$11,429	\$7,589
Aggregate number of Performance-Based RSUs outstanding at October 31	672,687	370,176
Performance-Based RSU expense recognized (in thousands)	\$6,946	\$3,952
Unamortized value of Performance-Based RSUs at October 31 (in thousands)	\$8,120	\$3,636

Stock Price-Based Restricted Stock Units:

In each of December 2010, 2009 and 2008, the Executive Compensation Committee approved awards to certain of its executives of market performance-based restricted stock units ("Stock Price-Based RSUs") relating to shares of the Company's common stock. In fiscal 2012, the Company adopted a Performance-Based Restricted Stock Award program to replace the Stock Price-Based RSU program. The Stock Price-Based RSUs will vest and the recipients will be entitled to receive the underlying shares if the average closing price of the Company's common stock on the NYSE, measured over any 20 consecutive trading days ending on or prior to five years from date of issuance of the Stock Price-Based RSUs increases 30% or more over the closing price of the Company's common stock on the NYSE on the date of issuance ("Target Price"), provided

the recipients continue to be employed by the Company or serve on the Board of Directors of the Company (as applicable) as specified in the award document.

In fiscal 2012, the Target Price of the Stock Price-Based RSUs issued in December 2010, 2009 and 2008 were met. The Stock Price-Based RSUs issued in December 2008 were paid in fiscal 2012. The recipient of this RSU elected to use a portion of the shares underlying the RSUs to pay the required income withholding taxes on the payout. The gross value of the RSU payout was \$5.9 million (200,000 shares), the income tax withholding was \$2.4 million (81,200 shares) and the net value of the shares delivered was \$3.5 million (118,800 shares).

The Stock Price-Based RSUs issued in December 2009 were paid in fiscal 2013. The recipient of these RSUs elected to use a portion of the shares underlying the RSUs to pay the required income withholding taxes on the payout. The gross value of the payout was \$6.5 million (200,000 shares), the income tax withholding was \$2.6 million (81,201 shares) and the net value of the shares delivered was \$3.8 million (118,799 shares).

In December 2010, the Executive Compensation Committee approved the award of a Stock Price-Based RSUs relating to 306,000 shares of the Company's common stock to certain senior management of the Company; the closing price of the Company's common stock on the NYSE on the date of the award was \$19.32 and the Target Price was \$25.12. Using a lattice based option pricing model and assuming an expected volatility of 48.22%, a risk-free interest rate of 1.99%, and an expected life of 3.0 years, the Company determined the aggregate value of the Stock Price-Based RSUs to be \$5.0 million. At October 31, 2013, 306,000 Stock Price-Based RSUs were outstanding and the unamortized value of these RSUs was \$0.2 million. In fiscal 2013, the Company recognized \$1.8 million of expense related to Stock Price-Based RSUs. The Company expects to distribute these Stock Price-Based RSUs in December 2013.

Non-performance Based Restricted Stock Units:

In December 2013, 2012 and 2011, the Company issued restricted stock units ("RSUs") to various officers, employees and directors. These RSUs generally vest in annual installments over a two- to four-year period. The value of the RSUs was determined to be equal to the number of shares of the Company's common stock to be issued pursuant to the RSUs, multiplied by the closing price of the Company's common stock on the NYSE on the date the RSUs were awarded. The following table provides information regarding these RSUs for fiscal 2013, 2012 and 2011.

	2013	2012	2011
Non-performance-Based RSUs issued:			
Number issued	94,080	107,820	15,497
Closing price of the Company's common stock on date of issuance	\$32.22	\$20.50	\$19.32
Aggregate fair value of RSUs issued (in thousands)	\$3,031	\$2,210	\$299
Non-performance-Based RSU expense recognized (in thousands):	\$2,490	\$156	\$144
	2013	2012	2011
At October 31:			
Aggregate Non-performance-Based RSUs outstanding	225,252	137,764	30,994
Cumulative unamortized value of Non-performance-Based RSUs (in thousands)	\$1,706	\$1,326	\$379

Restricted Stock Units in Lieu of Compensation

In December 2008, the Company issued restricted stock units ("RSUs in Lieu") relating to 62,051 shares of the Company's common stock to a number of employees in lieu of a portion of the employees' bonuses and in lieu of a portion of one employee's 2009 salary. These RSUs in Lieu vested in annual installments over a four-year period. Because the RSUs in Lieu are non-forfeitable, the value of the RSUs in Lieu was determined to be equal to the number of shares of the Company's common stock to be issued pursuant to the RSUs in Lieu multiplied by \$21.70, the closing price of the Company's common stock on the NYSE on December 19, 2008, the date the RSUs in Lieu were awarded. The amount applicable to employee bonuses was charged to the Company's accrual for bonuses that it made in fiscal 2008 and the amount applicable to salary deferral (\$130,000) was charged to selling, general and administrative expense in the three-month period ended January 31, 2009. The Company's stock incentive plan permits the Company to withhold from the total number of shares that otherwise would be issued to a RSUs in Lieu recipient

upon distribution that number of shares having a fair value at the time of distribution equal to the applicable income tax withholdings due and remit the remaining shares to the RSUs in Lieu participant.

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The following table provides information relating to the distribution of shares and the withholding of taxes on the RSUs in Lieu for fiscal 2013, 2012 and 2011.

	2013	2012	2011
Shares withheld	8,509	356	741
Shares issued	29,460	7,982	8,975
Value of shares withheld (in thousands)	\$308	\$10	\$15

At October 31, 2013, 2012 and 2011, 0, 38,000 and 46,000 RSUs in Lieu, respectively, were outstanding.

Employee Stock Purchase Plan

The Company's employee stock purchase plan enables substantially all employees to purchase the Company's common stock at 95% of the market price of the stock on specified offering dates without restriction or at 85% of the market price of the stock on specified offering dates subject to restrictions. The plan, which terminates in December 2017, provides that 1.2 million shares be reserved for purchase. At October 31, 2013, 574,000 shares were available for issuance.

The following table provides information regarding the Company's employee stock purchase plan for fiscal 2013, 2012 and 2011.

	2013	2012	2011
Shares issued	20,362	18,456	23,079
Average price per share	\$28.71	\$22.58	\$15.59
Compensation expense recognized (in thousands)	\$77	\$63	\$54

11. Income Per Share Information

Information pertaining to the calculation of income per share for each of the fiscal years ended October 31, 2013, 2012 and 2011 is as follows (amounts in thousands):

	2013	2012	2011
Numerator:			
Net income as reported	\$170,606	\$487,146	\$39,795
Plus: Interest and costs attributable to 0.5% Exchangeable Senior Notes, net of income tax benefit	1,604	78	
Numerator for diluted earnings per share	\$172,210	\$487,224	\$39,795
Denominator:			
Basic weighted-average shares	\$169,288	167,346	167,140
Common stock equivalents (a)	2,817	1,996	1,241
Shares attributable to 0.5% Exchangeable Senior Notes	5,858	812	
Diluted weighted-average shares	177,963	170,154	168,381
Other information:			
Weighted-average number of anti-dilutive options and restricted stock units (b)	1,509	3,646	7,936
Shares issued under stock incentive and employee stock purchase plans	1,213	2,927	2,390

Common stock equivalents represent the dilutive effect of outstanding in-the-money stock options using the (a) treasury stock method, Stock Price-Based RSUs whose Target Price criteria have been met but are unpaid and shares expected to be issued under Performance-Based Restricted Stock Units.

(b) Based upon the average of the average quarterly closing prices of the Company's common stock on the NYSE for the year.

12. Fair Value Disclosures

Financial Instruments

A summary of assets and (liabilities) at October 31, 2013 and 2012 related to the Company's financial instruments, measured at fair value on a recurring basis, is set forth below (amounts in thousands).

Financial Instrument	Fair value hierarchy	Fair value	
		October 31, 2013	October 31, 2012
Corporate Securities	Level 2	\$52,508	\$260,772
Certificates of Deposit	Level 2		\$148,112
Short-Term Tax-Exempt Bond Fund	Level 1		\$30,184
Residential Mortgage Loans Held for Sale	Level 2	\$113,517	\$86,386
Forward Loan Commitments - Residential Mortgage Loans Held for Sale	Level 2	\$(496)	\$(102)
Interest Rate Lock Commitments ("IRLCs")	Level 2	\$(181)	\$(202)
Forward Loan Commitments—IRLCs	Level 2	\$181	\$202

At October 31, 2013 and 2012, the carrying value of cash and cash equivalents and restricted cash approximated fair value.

Mortgage Loans Held for Sale

At the end of the reporting period, the Company determines the fair value of its mortgage loans held for sale and the forward loan commitments it has entered into as a hedge against the interest rate risk of its mortgage loans using the market approach to determine fair value. The evaluation is based on the current market pricing of mortgage loans with similar terms and values as of the reporting date and by applying such pricing to the mortgage loan portfolio. The Company recognizes the difference between the fair value and the unpaid principal balance of mortgage loans held for sale as a gain or loss. In addition, the Company recognizes the fair value of its forward loan commitments as a gain or loss. These gains and losses are included in other income - net. Interest income on mortgage loans held for sale is calculated based upon the stated interest rate of each loan and is included in other income - net.

The table below provides, for the periods indicated, the aggregate unpaid principal and fair value of mortgage loans held for sale as of the date indicated (amounts in thousands).

	Aggregate unpaid principal balance	Fair value	Excess
At October 31, 2013	\$111,896	\$113,517	\$1,621
At October 31, 2012	\$84,986	\$86,386	\$1,400

IRLCs represent individual borrower agreements that commit the Company to lend at a specified price for a specified period as long as there is no violation of any condition established in the commitment contract. These commitments have varying degrees of interest rate risk. The Company utilizes best-efforts forward loan commitments ("Forward Commitments") to hedge the interest rate risk of the IRLCs and residential mortgage loans held for sale. Forward Commitments represent contracts with third-party investors for the future delivery of loans whereby the Company agrees to make delivery at a specified future date at a specified price. The IRLCs and Forward Commitments are considered derivative financial instruments under ASC 815, "Derivatives and Hedging", which requires derivative financial instruments to be recorded at fair value. The Company estimates the fair value of such commitments based on the estimated fair value of the underlying mortgage loan and, in the case of IRLCs, the probability that the mortgage loan will fund within the terms of the IRLC. To manage the risk of non-performance of investors regarding the Forward Commitments, the Company assesses the credit worthiness of the investors on a periodic basis.

Marketable Securities

As of October 31, 2013 and 2012, the amortized cost, gross unrealized holding gains, gross unrealized holding losses, and fair value of marketable securities were as follows (amounts in thousands):

	October 31, 2013	October 31, 2012
Amortized cost	\$52,502	\$438,755
Gross unrealized holding gains	71	451
Gross unrealized holding losses	(65	) (138
Fair value	\$52,508	\$439,068

The estimated fair values of corporate securities and certificates of deposit are based on quoted prices provided by brokers. The remaining contractual maturities of marketable securities as of October 31, 2013 ranged from 3 months to 25 months.

Inventory

The Company recognizes inventory impairment charges based on the difference in the carrying value of the inventory and its fair value at the time of the evaluation. The fair value of the aforementioned inventory was determined using Level 3 criteria. See Note 1, "Significant Accounting Policies - Inventory" for additional information regarding the Company's methodology on determining fair value. As further discussed in Note 1, determining the fair value of a community's inventory involves a number of variables, many of which are interrelated. If the Company used a different input for any of the various unobservable inputs used in its impairment analysis, the results of the analysis may have been different, absent any other changes. The table below summarizes, for the periods indicated, the ranges of certain quantitative unobservable inputs utilized in determining the fair value of impaired communities.

	Selling price per unit (in thousands)	Sales pace per year (in units)	Discount rate
Three months ended October 31, 2013	\$315 - \$362	2 - 7	15.0%
Three months ended July 31, 2013	\$475 - \$500	2	15.0%
Three months ended April 30, 2013	—	—	—%
Three months ended January 31, 2013	\$303 - \$307	15	15.3%
Three months ended October 31, 2012	\$501 - \$536	11	18.3%
Three months ended July 31, 2012	\$175 - \$571	4 - 12	14.0% - 17.5%
Three months ended April 30, 2012	\$413 - \$472	6 - 17	17.5%
Three months ended January 31, 2012	\$344 - \$2,287	1 - 25	13.0% - 18.8%

The table below provides, for the periods indicated, the fair value of operating communities whose carrying value was adjusted and the amount of impairment charges recognized on operating communities (\$ amounts in thousands).

Three months ended:	Impaired operating communities			
	Number of communities tested	Number of communities	Fair value of communities, net of impairment charges	Impairment charges recognized
Fiscal 2013:				
January 31	60	2	\$5,377	\$700
April 30	79	1	\$749	340
July 31	76	1	\$191	100
October 31	63	2	\$6,798	2,200
				\$3,340
Fiscal 2012:				
January 31	113	8	\$49,758	\$6,425
April 30	115	2	\$22,962	2,560
July 31	115	4	\$6,609	2,685
October 31	108	3	\$9,319	1,400
				\$13,070

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Fiscal 2011:

January 31	143	6	\$56,105	\$5,475
April 30	142	9	\$40,765	10,725
July 31	129	2	\$867	175
October 31	114	3	\$3,367	710
				\$17,085

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Investments in Distressed Loans and REO

Gibraltar's distressed loans were recorded at estimated fair value at inception based on the acquisition price as determined by Level 3 inputs and was based on the estimated discounted future cash flows to be generated by the loans discounted at the rates used to value the portfolios at the acquisition dates. The table below provides, as of the dates indicated, the carrying amount and estimated fair value of distressed loans (amounts in thousands).

	October 31, 2013	October 31, 2012
Carrying amount	\$36,374	\$37,169
Estimated fair value	\$45,355	\$38,109

Gibraltar's REO was recorded at estimated fair value at the time it was acquired through foreclosure or deed in lieu actions using Level 3 inputs. The valuation techniques used to estimate fair value are third-party appraisals, broker opinions of value, or internal valuation methodologies (which may include discounted cash flows, capitalization rate analysis or comparable transactional analysis). Unobservable inputs used in estimating the fair value of REO assets are based upon the best information available under the circumstances and take into consideration the financial condition and operating results of the asset, local market conditions, the availability of capital, interest and inflation rates and other factors deemed appropriate by management.

Acquisition of CamWest

The purchase price allocation performed in connection with our acquisition of CamWest was primarily based on Level 3 inputs. The assets acquired were primarily inventory. The valuation techniques used to value this inventory were similar to the criteria used in valuing inventory as described in Note 1, "Significant Accounting Policies - Inventory".

Debt

The table below provides, as of the dates indicated, the book value and estimated fair value of the Company's debt at October 31, 2013 and 2012 (amounts in thousands).

	Fair value hierarchy	October 31, 2013		October 31, 2012	
		Book value	Estimated fair value	Book value	Estimated fair value
Loans payable (a)	Level 2	\$107,222	\$106,988	\$99,817	\$99,093
Senior notes (b)	Level 1	2,325,336	2,458,737	2,089,189	2,340,189
Mortgage company warehouse loan (c)	Level 2	75,000	75,000	72,664	72,664
		\$2,507,558	\$2,640,725	\$2,261,670	\$2,511,946

(a) The estimated fair value of loans payable was based upon interest rates that the Company believed were available to it for loans with similar terms and remaining maturities as of the applicable valuation date.

(b) The estimated fair value of the Company's senior notes is based upon their indicated market prices.

(c) The Company believes that the carrying value of its mortgage company loan borrowings approximates their fair value.

13. Employee Retirement and Deferred Compensation Plans

Salary Deferral Savings Plans

The Company maintains salary deferral savings plans covering substantially all employees. During the first quarter of fiscal 2009, due to the continued downturn in the Company's business, the Company suspended its matching contributions and discretionary contributions to one of the plans. In fiscal 2011, the Company elected to make a discretionary contribution of 1% of eligible compensation for the plan year ended December 31, 2010. The Company made a 1% discretionary contribution for the plan year ended December 31, 2011, made a contribution of 2% of eligible compensation for the plan year ended December 31, 2012, and intends to make a 2% contribution for the plan year ending December 31, 2013. Beginning in the third quarter of fiscal 2011, the Company resumed a matching contribution of up to 1% of eligible compensation for employees electing to contribute via salary deferrals and increased the matching contribution to 2% in January 2012. The Company recognized an expense, net of plan forfeitures, with respect to the plans of \$6.4 million, \$5.0 million and \$2.7 million for the fiscal years ended October 31, 2013, 2012 and 2011, respectively.

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Deferred Compensation Plan

The Company has an unfunded, non-qualified deferred compensation plan that permits eligible employees to defer a portion of their compensation. The deferred compensation, together with certain Company contributions, earns various rates of return depending upon when the compensation was deferred and the length of time that it has been deferred. A portion of the deferred compensation and interest earned may be forfeited by a participant if he or she elects to withdraw the compensation prior to the end of the deferral period. At October 31, 2013 and 2012, the Company had accrued \$20.4 million and \$20.7 million, respectively, for its obligations under the plan.

Defined Benefit Retirement Plans

The Company has two unfunded defined benefit retirement plans. Retirement benefits generally vest when the participant has completed 15 or 20 years of service with the Company and reaches normal retirement age (age 62). Unrecognized prior service costs are being amortized over the period from the date participants enter the plans until their interests are fully vested. The Company used a 4.01%, 3.07% and 4.06% discount rate in its calculation of the present value of its projected benefit obligations at October 31, 2013, 2012 and 2011, respectively. The rates represent the approximate long-term investment rate at October 31 of the fiscal year for which the present value was calculated. Information related to the plans is based on actuarial information calculated as of October 31, 2013, 2012 and 2011.

Information related to the Company's retirement plans for each of the fiscal years ended October 31, 2013, 2012 and 2011 is as follows (amounts in thousands):

	2013	2012	2011
Plan costs:			
Service cost	\$471	\$389	\$305
Interest cost	1,044	1,212	1,290
Amortization of prior service cost	843	737	694
Amortization of unrecognized losses	144	66	
	\$2,502	\$2,404	\$2,289
Projected benefit obligation:			
Beginning of year	\$34,319	\$29,766	\$26,037
Plan amendments adopted during year	826	575	
Service cost	471	389	305
Interest cost	1,044	1,212	1,290
Benefit payments	(888)	(731)	(504)
Change in unrecognized loss (gain)	(3,636)	3,108	2,638
Projected benefit obligation, end of year	\$32,136	\$34,319	\$29,766
Unamortized prior service cost:			
Beginning of year	\$3,171	\$3,333	\$4,027
Plan amendments adopted during year	826	575	
Amortization of prior service cost	(843)	(737)	(694)
Unamortized prior service cost, end of year	\$3,154	\$3,171	\$3,333
Accumulated unrecognized (loss) gain, October 31	\$(527)	\$(4,307)	\$(1,265)
Accumulated benefit obligation, October 31	\$32,136	\$34,319	\$29,766
Accrued benefit obligation, October 31	\$32,136	\$34,319	\$29,766

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The table below provides, based upon the estimated retirement dates of the participants in the retirement plans, the amounts of benefits the Company would be required to pay in each of the next five fiscal years and for the five fiscal years ended October 31, 2023 in the aggregate (in thousands).

Year ending October 31,	Amount
2014	\$888
2015	\$1,645
2016	\$1,770
2017	\$2,008
2018	\$2,104
November 1, 2018 - October 31, 2023	\$12,968

14. Accumulated Other Comprehensive (Loss) Income

The table below provides, for the fiscal year ended October 31, 2013, the components of accumulated other comprehensive (loss) income (amounts in thousands):

	Employee retirement plans	Available-for-sale securities	Derivative instruments	Total
Balance, beginning of period	\$(4,446	) \$ 181	\$(554	) \$(4,819
Other comprehensive income (loss) before reclassifications	2,810	(231	) 435	3,014
Gross amounts reclassified from accumulated other comprehensive income (loss)	987	(57	)	930
Income tax (expense) benefit	(1,463	) 102	(151	) (1,512
Other comprehensive income (loss), net of tax	2,334	(186	) 284	2,432
Balance, end of period	\$(2,112	) \$ (5	) \$(270	) \$(2,387

Reclassifications for the amortization of the employee retirement plans are included in selling, general and administrative expense in the Consolidated Statements of Operations. See Note 13 - "Employee Retirement and Deferred Compensation Plans" for additional information. Reclassifications for the realized loss on available-for-sale securities are included in other income - net in the Consolidated Statements of Operations.

15. Commitments and Contingencies

Land Purchase Commitments

Generally, the Company's option and purchase agreements to acquire land parcels do not require the Company to purchase those land parcels, although the Company may, in some cases, forfeit any deposit balance outstanding if and when it terminates an option and purchase agreement. If market conditions are weak, approvals needed to develop the land are uncertain or other factors exist that make the purchase undesirable, the Company may not expect to acquire the land. Whether an option and purchase agreement is legally terminated or not, the Company reviews the amount recorded for the land parcel subject to the option and purchase agreement to determine if the amount is recoverable. While the Company may not have formally terminated the option and purchase agreements for those land parcels that it does not expect to acquire, it has written off any non-refundable deposits and costs previously capitalized to such land parcels in the periods that it determined such costs were not recoverable.

Information regarding the Company's land purchase commitments at October 31, 2013 and 2012 is provided in the table below (amounts in thousands).

	2013	2012
Aggregate purchase commitments:		
Unrelated parties	\$1,301,987	\$742,918
Unconsolidated entities that the Company has investments in	61,738	4,067
Total	\$1,363,725	\$746,985
Deposits against aggregate purchase commitments	\$76,986	\$42,921
Additional cash required to acquire land	1,286,739	704,064
Total	\$1,363,725	\$746,985
Amount of additional cash required to acquire land included in accrued expenses	\$1,439	\$4,328

In addition, the Company expects to purchase approximately 545 additional home sites from a joint venture in which it has a 50% interest. The purchase price of the home sites will be determined at a future date.

At October 31, 2013, the Company had purchase commitments to acquire land for apartment developments of approximately \$56.0 million, of which it had outstanding deposits in the amount of \$2.5 million. At October 31, 2013, the Company also had a purchase commitment to acquire a parcel of land for approximately \$79.3 million which it intends to develop with a joint venture partner; the Company expects to purchase up to 1,750 home sites from the joint venture and the joint venture expects to sell the remaining home sites to outside builders. In December 2013, the joint venture was formed and the joint venture acquired the land. In November 2013, the Company entered into an agreement to acquire Shapell for \$1.60 billion. See Note 1 - "Significant Accounting Policies - Subsequent Events" for more information on the Shapell acquisition.

The Company has additional land parcels under option that have been excluded from the aforementioned aggregate purchase amounts since it does not believe that it will complete the purchase of these land parcels and no additional funds will be required from the Company to terminate these contracts.

Legal Proceedings

The Company is involved in various claims and litigation arising principally in the ordinary course of business. The Company believes that adequate provision for resolution of all current claims and pending litigation has been made for probable losses and the disposition of these matters will not have a material adverse effect on the Company's results of operations and liquidity or on its financial condition.

Investments in and Advances to Unconsolidated Entities

At October 31, 2013, the Company had investments in and advances to a number of unconsolidated entities, was committed to invest or advance additional funds and had guaranteed a portion of the indebtedness and/or loan commitments of these entities. See Note 4, "Investments in and Advances to Unconsolidated Entities," for more information regarding the Company's commitments to these entities.

Surety Bonds and Letters of Credit

At October 31, 2013, the Company had outstanding surety bonds amounting to \$409.6 million, primarily related to its obligations to various governmental entities to construct improvements in the Company's various communities. The Company estimates that \$290.9 million of work remains on these improvements. The Company has an additional \$62.2 million of surety bonds outstanding that guarantee other obligations of the Company. The Company does not believe it is probable that any outstanding bonds will be drawn upon.

At October 31, 2013, the Company had outstanding letters of credit of \$89.3 million, including \$76.6 million under its Credit Facility and \$12.7 million collateralized by restricted cash. These letters of credit were issued to secure various financial obligations of the Company including insurance policy deductibles and other claims, land deposits and security to complete improvements in communities in which it is operating. The Company believes it is not probable that any outstanding letters of credit will be drawn upon.

Backlog

At October 31, 2013, the Company had agreements of sale outstanding to deliver 3,679 homes with an aggregate sales value of \$2.63 billion.

Mortgage Commitments

The Company's mortgage subsidiary provides mortgage financing for a portion of the Company's home closings. For those home buyers to whom the Company's mortgage subsidiary provides mortgages, it determines whether the home buyer qualifies for the mortgage he or she is seeking based upon information provided by the home buyer and other sources. For those home buyers who qualify, the Company's mortgage subsidiary provides the home buyer with a mortgage commitment that specifies the terms and conditions of a proposed mortgage loan based upon then-current market conditions. Prior to the actual closing of the home and funding of the mortgage, the home buyer will lock in an interest rate based upon the terms of the commitment. At the time of rate lock, the Company's mortgage subsidiary agrees to sell the proposed mortgage loan to one of several outside recognized mortgage financing institutions ("investors") that are willing to honor the terms and conditions, including interest rate, committed to the home buyer. The Company believes that these investors have adequate financial resources to honor their commitments to its mortgage subsidiary.

Information regarding the Company's mortgage commitments at October 31, 2013 and 2012 is provided in the table below (amounts in thousands).

	2013	2012
Aggregate mortgage loan commitments:		
IRLCs	\$247,995	\$111,173
Non-IRLCs	645,288	456,825
Total	\$893,283	\$567,998
Investor commitments to purchase:		
IRLCs	\$247,995	\$111,173
Mortgage loans receivable	107,873	80,697
Total	\$355,868	\$191,870

Rent Expense and Future Rent Payments

The Company leases certain facilities and equipment under non-cancelable operating leases. Rental expense incurred by the Company under these operating leases were (amounts in thousands):

Year ending October 31,	Amount
2013	\$10,973
2012	\$11,183
2011	\$12,405

At October 31, 2013, future minimum rent payments under the Company's operating leases were (amounts in thousands):

Year ending October 31,	Amount
2014	\$9,619
2015	8,137
2016	6,619
2017	5,141
2018	4,111
Thereafter	3,659
	\$37,286

16. Other Income - Net

The table below provides the components of other income - net for the years ended October 31, 2013, 2012 and 2011 (amounts in thousands):

	2013	2012	2011
Interest income	\$4,457	\$4,677	\$5,210
Income from ancillary businesses	9,912	6,608	3,734
Gibraltar	10,185	4,476	1,522
Management fee income	2,890	2,212	5,137
Retained customer deposits	2,534	3,247	2,076
Land sales, net	4,435	1,425	1,350
Income recognized from settlement of litigation	13,229		
Other	4,596	3,276	4,374
Total other income - net	\$52,238	\$25,921	\$23,403

Income recognized from the settlement of litigation was the result of the settlement of three derivative lawsuits brought on behalf of the Company against certain officers and directors of the Company. The gross settlement of \$16.2 million was reduced by the payment of attorney's fees of \$3.0 million. The Company's insurance carriers paid approximately \$9.8 million and certain officers and former officers paid the remainder.

Income from ancillary businesses includes the activity of the Company's non-core businesses which include its mortgage, title, landscaping, security monitoring, and golf course and country club operations. The table below provides revenues and expenses for the Company's non-core ancillary businesses for the years ended October 31, 2013, 2012 and 2011 (amounts in thousands):

	2013	2012	2011
Revenue	\$89,182	\$67,137	\$60,021
Expense	\$79,270	\$60,529	\$56,287

17. Information on Operating Segments

The table below summarizes revenue and income (loss) before income taxes for each of the Company's reportable segments for each of the fiscal years ended October 31, 2013, 2012 and 2011 (amounts in thousands):

	Revenues			Income (loss) before income taxes		
	2013	2012	2011	2013	2012	2011
Traditional Home Building:						
North	\$485,052	\$350,639	\$320,797	\$32,648	\$13,913	\$11,504
Mid-Atlantic	652,855	535,710	465,142	79,801	62,970	48,762
South	641,331	361,810	273,303	67,934	18,928	(25,272)
West	724,370	437,922	309,553	111,301	39,383	(27,113)
Traditional Home Building	2,503,608	1,686,081	1,368,795	291,684	135,194	7,881
City Living	170,691	196,700	107,086	53,345	61,910	39,201
Corporate and other				(77,332)	(84,162)	(76,448)
Total	\$2,674,299	\$1,882,781	\$1,475,881	\$267,697	\$112,942	\$(29,366)

"Corporate and other" is comprised principally of general corporate expenses such as the Offices of the Executive Chairman, the Chief Executive Officer, and the corporate finance, accounting, audit, tax, human resources, risk management, marketing and legal groups, directly expensed interest, offset, in part, by interest income and income from the Company's ancillary businesses and income from a number of its unconsolidated entities.

Total assets for each of the Company's operating segments at October 31, 2013 and 2012 are shown in the table below (amounts in thousands):

	2013	2012
Traditional Home Building:		
North	\$963,597	\$757,412
Mid-Atlantic	1,231,438	1,155,715
South	953,955	800,268
West	1,290,388	904,374
Traditional Home Building	4,439,378	3,617,769
City Living	674,302	486,970
Corporate and other	1,713,779	2,076,305
Total	\$6,827,459	\$6,181,044

"Corporate and other" is comprised principally of cash and cash equivalents, marketable securities, deferred tax assets and the assets of the Company's Gibraltar investments, manufacturing facilities and mortgage subsidiary.

The Company provided for inventory impairment charges and the expensing of costs that it believed not to be recoverable and write-downs of investments in unconsolidated entities (including the Company's pro-rata share of impairment charges recognized by the unconsolidated entities in which it has an investment) for the years ended October 31, 2013, 2012 and 2011, as shown in the table below; the net carrying value of inventory and investments in and advances to unconsolidated entities for each of the Company's geographic segments at October 31, 2013 and 2012 is also shown (amounts in thousands).

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	Net Carrying Value		Impairments		
	At October 31,		Year ended October 31,		
	2013	2012	2013	2012	2011
Inventory:					
Land controlled for future communities:					
Traditional Home Building:					
North	\$16,267	\$10,606	\$822	\$(907	) \$906
Mid-Atlantic	29,423	25,573	322	238	307
South	14,606	7,724	400	800	313
West	13,371	8,131	(361	) 205	16,184
Traditional Home Building	73,667	52,034	1,183	336	17,710
City Living	26,135	2,590		115	42
	99,802	54,624	1,183	451	17,752
Land owned for future communities:					
Traditional Home Building:					
North	135,282	29,791			
Mid-Atlantic	308,585	396,562		300	300
South	158,457	141,644		918	16,700
West	448,125	232,546			
Traditional Home Building	1,050,449	800,543	—	1,218	17,000
City Living	237,181	213,022			
	1,287,630	1,013,565	—	1,218	17,000
Operating communities:					
Traditional Home Building:					
North	785,175	701,253	940	2,725	2,885
Mid-Atlantic	866,256	707,873	200	5,500	3,700
South	690,302	597,840	2,000	3,445	3,800
West	697,573	528,451	200	600	6,700
Traditional Home Building	3,039,306	2,535,417	3,340	12,270	17,085
City Living	223,674	129,097		800	
	3,262,980	2,664,514	3,340	13,070	17,085
Total	\$4,650,412	\$3,732,703	\$4,523	\$14,739	\$51,837
Investments in and advances to unconsolidated entities:					
Traditional Home Building:					
Mid-Atlantic	\$11,850				
South	50,452	\$31,252			\$15,170
West	110,467	116,452		\$(2,311	) 25,700
Traditional Home Building	172,769	147,704	—	(2,311	) 40,870
City Living	135,950	104,436			
Corporate and other	94,414	78,477			
Total	\$403,133	\$330,617	\$—	\$(2,311) \$40,870

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18. Supplemental Disclosure to Consolidated Statements of Cash Flows

The following are supplemental disclosures to the Consolidated Statements of Cash Flows for each of the fiscal years ended October 31, 2013, 2012 and 2011 (amounts in thousands):

	2013	2012	2011
Cash flow information:			
Interest paid, net of amount capitalized	\$18,187	\$1,223	\$18,666
Income tax payment	\$3,130	4,264	
Income tax refunds	\$1,190		\$154,524
Non-cash activity:			
Cost of inventory acquired through seller financing or municipal bonds, net	\$45,726	\$26,059	\$29,320
Financed portion of land sale	\$7,200		
Reduction in inventory for Company's share of earnings in land purchased from unconsolidated entities	\$3,035		
Transfer of investment in REO to inventory	\$764		
Reclassification of deferred income from inventory to accrued liabilities	\$4,545		
Miscellaneous (decreases) increases to inventory		\$(478)	) \$1,781
Reclassification of inventory to property, construction and office equipment	\$5,576		\$20,005
Increase (decrease) in unrecognized losses in defined benefit plans	\$(3,636)	) \$3,108	\$2,638
Defined benefit plan amendment	\$826	575	
Income tax benefit related to exercise of employee stock options	\$24,417	3,885	
Increase in accrued expenses related to Stock Price-Based RSUs paid	\$2,942		
Income tax (expense) benefit recognized in total comprehensive income	\$(1,512)	) \$1,263	
(Increase) reduction of investments in unconsolidated entities due to increase/reduction in letters of credit or accrued liabilities		\$448	\$13,423
Transfer of inventory to investment in distressed loans and foreclosed real estate		\$(802))
Transfer of inventory to investment in unconsolidated entities	\$54,761	\$5,793	
Reclassification of deferred income from investment in unconsolidated entities to accrued liabilities		\$2,943	
Reclassification of stock-based compensation from accrued liabilities to additional paid-in capital			4,233
Unrealized gain (loss) on derivative held by equity investee	\$435	\$(875))
Increase in investments in unconsolidated entities for change in the fair value of debt guarantees	\$1,582		
Miscellaneous decreases to investments in unconsolidated entities	\$(1,811)	) \$(276)	) \$(2,212)
Acquisition of Business:			
Fair value of assets purchased		149,959	
Liabilities assumed		5,213	
Cash paid	\$—	144,746	—

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19. Supplemental Guarantor Information

A 100% - owned subsidiary of the Company, Toll Brothers Finance Corp. (the “Subsidiary Issuer”), has issued the following Senior Notes (amounts in thousands):

	Original Amount Issued	Amount outstanding at October 31, 2013
4.95% Senior Notes due 2014	\$300,000	\$267,960
5.15% Senior Notes due 2015	\$300,000	\$300,000
8.91% Senior Notes due 2017	\$400,000	\$400,000
6.75% Senior Notes due 2019	\$250,000	\$250,000
5.875% Senior Notes due 2022	\$419,876	\$419,876
0.50% Exchangeable Senior Notes due 2032	\$287,500	\$287,500
4.375% Senior Notes due 2023	\$400,000	\$400,000

The obligations of the Subsidiary Issuer to pay principal, premiums, if any, and interest are guaranteed jointly and severally on a senior basis by the Company and substantially all of the Company’s 100% owned home building subsidiaries (the “Guarantor Subsidiaries”). The guarantees are full and unconditional. The Company’s non-home building subsidiaries and several of its home building subsidiaries (together, the “Non-Guarantor Subsidiaries”) do not guarantee the debt. The Subsidiary Issuer generates no operating revenues and does not have any independent operations other than the financing of other subsidiaries of the Company by lending the proceeds from the above described debt issuances.

Separate financial statements and other disclosures concerning the Guarantor Subsidiaries are not presented because management has determined that such disclosures would not be material to investors.

The condensed consolidating balance sheet at October 31, 2012 has been revised in order to reflect an inventory reclass between Guarantor Subsidiaries and Non-Guarantor subsidiaries of \$44.3 million as of October 31, 2012 as a result of an error made when certain non-guarantor subsidiaries became guarantor subsidiaries as of April 30, 2013. This change has no impact or effect on Toll Brothers, Inc.’s consolidated financial statements for any period presented, including the Consolidated Balance Sheets, Statements of Operations, Statements of Comprehensive Income, or Statements of Cash Flows.

The table below provides information regarding the correction made to the previously reported fiscal 2012 condensed consolidating balance sheet. The Increase/Decrease column also includes reclassifications made in order to conform the 2012 condensed consolidating balance sheet to the fiscal 2013 presentation related to (i) the reclassification of \$28.5 million of land inventory primarily related to commercial properties located in two of its master planned communities to receivables, prepaid expenses and other assets (see Note 3, "Inventory") and (ii) the reclassification of \$3.8 million of in-process fixed asset project costs from receivables, prepaid expenses and other assets to property, construction and office equipment. The condensed consolidating statements of cash flows for the years ended October 31, 2012 and 2011, have also been revised to reflect these changes.

	As previously reported	Increase (Decrease)	As reclassified
Inventory			
Guarantor Subsidiaries	\$3,695,895	\$15,784	\$3,711,679
Non-Guarantor Subsidiaries	\$65,292	\$(44,268)	) \$21,024
Property, construction and office equipment, net			
Guarantor Subsidiaries	\$103,206	\$3,757	\$106,963
Receivables, prepaid and other assets			
Guarantor Subsidiaries	\$79,949	\$22,460	\$102,409
Non-Guarantor Subsidiaries	\$64,543	\$2,267	\$66,810
Customer deposits held in escrow			
Guarantor Subsidiaries	\$27,312	\$2,267	\$29,579
Non-Guarantor Subsidiaries	\$2,267	\$(2,267)) \$—
Total assets			
Guarantor Subsidiaries	\$5,199,704	\$44,268	\$5,243,972
Non-Guarantor Subsidiaries	\$595,933	\$(44,268)	) \$551,665
Advances from consolidated entities			
Guarantor Subsidiaries	\$1,341,189	\$44,268	\$1,385,457
Non-Guarantor Subsidiaries	\$393,195	\$(44,268)	) \$348,927
Total liabilities			
Guarantor Subsidiaries	\$2,028,369	\$44,268	\$2,072,637
Non-Guarantor Subsidiaries	\$581,861	\$(44,268)	) \$537,593

Supplemental consolidating financial information of Toll Brothers, Inc., the Subsidiary Issuer, the Guarantor Subsidiaries, the Non-Guarantor Subsidiaries and the eliminations to arrive at Toll Brothers, Inc. on a consolidated basis is presented below (\$ amounts in thousands).

Consolidating Balance Sheet at October 31, 2013

	Toll Brothers, Inc.	Subsidiary Issuer	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS						
Cash and cash equivalents	—	—	670,102	102,870	—	772,972
Marketable securities			42,491	10,017		52,508
Restricted cash	15,182		16,007	847		32,036
Inventory			4,625,252	25,160		4,650,412
Property, construction and office equipment, net			116,809	14,511		131,320
Receivables, prepaid expenses and other assets	33	15,675	101,321	131,701	(19,435)	229,295
Mortgage loans receivable				113,517		113,517
Customer deposits held in escrow			46,888			46,888
Investments in and advances to unconsolidated entities			175,159	227,974		403,133
Investments in distressed loans				36,374		36,374
Investments in foreclosed real estate				72,972		72,972
Investments in and advances to consolidated entities	3,113,203	2,334,503	4,740		(5,452,446)	—
Deferred tax assets, net of valuation allowances	286,032					286,032
	3,414,450	2,350,178	5,798,769	735,943	(5,471,881)	6,827,459
LIABILITIES AND EQUITY						
Liabilities						
Loans payable			107,222			107,222
Senior notes		2,282,719			38,723	2,321,442
Mortgage company warehouse loan				75,000		75,000
Customer deposits			212,669			212,669
Accounts payable			167,733	54		167,787
Accrued expenses		25,045	355,590	161,402	(19,050)	522,987
Investments in and advances to consolidated entities			1,627,130	467,929	(2,095,059)	—
Income taxes payable	81,188					81,188
Total liabilities	81,188	2,307,764	2,470,344	704,385	(2,075,386)	3,488,295
Equity						
Stockholders' equity						
Common stock	1,694		48	3,006	(3,054)	1,694
Additional paid-in capital	441,677	49,400		1,734	(51,134)	441,677
Retained earnings	2,892,003	(6,986)	3,328,629	20,664	(3,342,307)	2,892,003
Treasury stock, at cost						—
Accumulated other comprehensive loss	(2,112)		(252)	(23)		(2,387)
Total stockholders' equity	3,333,262	42,414	3,328,425	25,381	(3,396,495)	3,332,987
Noncontrolling interest				6,177		6,177

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Total equity	3,333,262	42,414	3,328,425	31,558	(3,396,495)	3,339,164
	3,414,450	2,350,178	5,798,769	735,943	(5,471,881)	6,827,459

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Consolidating Balance Sheet at October 31, 2012

	Toll Brothers, Inc.	Subsidiary Issuer	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS						
Cash and cash equivalents	—	—	712,024	66,800	—	778,824
Marketable securities			378,858	60,210		439,068
Restricted cash	28,268		17,561	1,447		47,276
Inventory			3,711,679	21,024		3,732,703
Property, construction and office equipment, net			106,963	3,008		109,971
Receivables, prepaid expenses and other assets	134	15,130	102,409	66,810	(11,441)	173,042
Mortgage loans receivable				86,386		86,386
Customer deposits held in escrow			29,579			29,579
Investments in and advances to unconsolidated entities			180,159	150,458		330,617
Investments in distressed loans				37,169		37,169
Investments in foreclosed real estate				58,353		58,353
Investments in and advances to consolidated entities	2,816,607	2,092,810	4,740		(4,914,157)	—
Deferred tax assets, net of valuation allowances	358,056					358,056
	3,203,065	2,107,940	5,243,972	551,665	(4,925,598)	6,181,044
LIABILITIES AND EQUITY						
Liabilities						
Loans payable			99,817			99,817
Senior notes		2,032,335			48,128	2,080,463
Mortgage company warehouse loan				72,664		72,664
Customer deposits			142,919	58		142,977
Accounts payable			99,889	22		99,911
Accrued expenses		27,476	344,555	115,922	(11,603)	476,350
Advances from consolidated entities			1,385,457	348,927	(1,734,384)	—
Income taxes payable	80,991					80,991
Total liabilities	80,991	2,059,811	2,072,637	537,593	(1,697,859)	3,053,173
Equity						
Stockholders' equity						
Common stock	1,687		48	3,006	(3,054)	1,687
Additional paid-in capital	404,418	49,400		1,734	(51,134)	404,418
Retained earnings	2,721,397	(1,271)	3,171,654	3,168	(3,173,551)	2,721,397
Treasury stock, at cost	(983)					(983)
Accumulated other comprehensive loss	(4,445)		(367)	(7)		(4,819)
Total stockholders' equity	3,122,074	48,129	3,171,335	7,901	(3,227,739)	3,121,700
Noncontrolling interest				6,171		6,171
Total equity	3,122,074	48,129	3,171,335	14,072	(3,227,739)	3,127,871
	3,203,065	2,107,940	5,243,972	551,665	(4,925,598)	6,181,044

Consolidating Statement of Operations for the fiscal year ended October 31, 2013

	Toll Brothers, Inc.	Subsidiary Issuer	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated
Revenues			2,711,438	70,107	(107,246)	2,674,299
Cost of revenues			2,149,554	10,043	(26,297)	2,133,300
Selling, general and administrative	188	2,963	364,256	48,413	(75,888)	339,932
	188	2,963	2,513,810	58,456	(102,185)	2,473,232
Income (loss) from operations	(188)	(2,963)	197,628	11,651	(5,061)	201,067
Other:						
Income from unconsolidated entities			9,318	5,074		14,392
Other income - net	9,433		32,217	12,616	(2,028)	52,238
Intercompany interest income		127,057			(127,057)	—
Interest expense		(133,500)		(646)	134,146	—
Income from consolidated subsidiaries	258,452		19,289		(277,741)	—
Income (loss) before income taxes	267,697	(9,406)	258,452	28,695	(277,741)	267,697
Income tax provision (benefit)	97,091	(3,691)	101,416	11,260	(108,985)	97,091
Net income (loss)	170,606	(5,715)	157,036	17,435	(168,756)	170,606
Other comprehensive income (loss)	2,334		114	(16)		2,432
Total comprehensive income (loss)	172,940	(5,715)	157,150	17,419	(168,756)	173,038

Consolidating Statement of Operations for the fiscal year ended October 31, 2012

	Toll Brothers, Inc.	Subsidiary Issuer	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated
Revenues			1,903,177	57,581	(77,977)	1,882,781
Cost of revenues			1,541,937	10,597	(20,439)	1,532,095
Selling, general and administrative	95	2,965	309,923	38,424	(64,150)	287,257
	95	2,965	1,851,860	49,021	(84,589)	1,819,352
Income (loss) from operations	(95)	(2,965)	51,317	8,560	6,612	63,429
Other:						
Income from unconsolidated entities			18,342	5,250		23,592
Other income - net	1,327		20,032	10,181	(5,619)	25,921
Intercompany interest income		116,835			(116,835)	—
Interest expense		(115,141)		(701)	115,842	—
Income from consolidated subsidiaries	111,710		22,019		(133,729)	—
Income (loss) before income taxes	112,942	(1,271)	111,710	23,290	(133,729)	112,942
Income tax (benefit) provision	(374,204)		25,515	5,319	(30,834)	(374,204)
Net income (loss)	487,146	(1,271)	86,195	17,971	(102,895)	487,146
Other comprehensive loss	(1,839)		(71)	(7)		(1,917)
Total comprehensive income (loss)	485,307	(1,271)	86,124	17,964	(102,895)	485,229

Consolidating Statement of Operations for the fiscal year ended October 31, 2011

	Toll Brothers, Inc.	Subsidiary Issuer	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated
Revenues			1,502,147	48,365	(74,631)	1,475,881
Cost of revenues			1,274,173	4,314	(17,717)	1,260,770
Selling, general and administrative	137	1,345	279,131	33,605	(52,863)	261,355
	137	1,345	1,553,304	37,919	(70,580)	1,522,125
(Loss) income from operations	(137)	(1,345)	(51,157)	10,446	(4,051)	(46,244)
Other:						
(Loss) Income from unconsolidated entities			(18,905)	17,711		(1,194)
Other income - net			15,784	(1,359)	8,978	23,403
Intercompany interest income		108,776			(108,776)	—
Interest expense		(103,604)	(1,504)	(245)	103,849	(1,504)
Expenses related to early retirement of debt		(3,827)				(3,827)
(Loss) income from consolidated subsidiaries	(29,229)		26,553		2,676	—
(Loss) income before income taxes	(29,366)	—	(29,229)	26,553	2,676	(29,366)
Income tax (benefit) provision	(69,161)		(68,837)	62,536	6,301	(69,161)
Net income (loss)	39,795	—	39,608	(35,983)	(3,625)	39,795
Other comprehensive loss	(1,934)		(192)			(2,126)
Total comprehensive income (loss)	37,861	—	39,416	(35,983)	(3,625)	37,669

Consolidating Statement of Cash Flows for the fiscal year ended October 31, 2013

	Toll Brothers, Inc.	Subsidiary Issuer	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated
Net cash (used in) provided by operating activities	116,508	5,163	(587,032)	(92,899)	(10,703)	(568,963)
Cash flow provided by (used in) investing activities:						
Purchase of property and equipment — net			(15,038)	(11,529)		(26,567)
Purchase of marketable securities			(25,938)	(10,264)		(36,202)
Sale and redemption of marketable securities			357,583	60,263		417,846
Investment in and advances to unconsolidated entities			(34,071)	(59,327)		(93,398)
Return of investments in unconsolidated entities			43,405	26,404		69,809
Investment in non-performing loan portfolios and foreclosed real estate				(26,155)		(26,155)
Return of investments in non-performing loan portfolios and foreclosed real estate				27,370		27,370
Intercompany advances	(141,346)	(241,693)			383,039	—
Net cash provided by (used in) investing activities	(141,346)	(241,693)	325,941	6,762	383,039	332,703
Cash flow provide by (used in) financing activities:						
Net proceeds from issuance of senior notes		400,383				400,383
Proceeds from loans payable				1,164,531		1,164,531
Principal payments of loans payable			(33,329)	(1,162,195)		(1,195,524)
Redemption of senior notes		(163,853)				(163,853)
Proceeds from stock-based benefit plans	15,798					15,798
Excess tax benefits from stock-based compensation	24,417					24,417
Purchase of treasury stock	(15,377)					(15,377)
Change in noncontrolling interest				33		33
Intercompany advances			252,498	119,838	(372,336)	—
Net cash provided by (used in) financing activities	24,838	236,530	219,169	122,207	(372,336)	230,408
Net (decrease) increase in cash and cash equivalents	—	—	(41,922)	36,070	—	(5,852)
Cash and cash equivalents, beginning of year	—	—	712,024	66,800	—	778,824
Cash and cash equivalents, end of year	—	—	670,102	102,870	—	772,972

Consolidating Statement of Cash Flows for the fiscal year ended October 31, 2012

	Toll Brothers, Inc.	Subsidiary Issuer	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated
Net cash (used in) provided by operating activities	4,365	5,564	(100,007)	(78,750)	(2,709)	(171,537)
Cash flow used in investing activities:						
Purchase of property and equipment — net			(12,012)	92		(11,920)
Purchase of marketable securities			(519,737)	(60,221)		(579,958)
Sale and redemption of marketable securities			368,253			368,253
Investment in and advances to unconsolidated entities			(113,651)	(103,509)		(217,160)
Return of investments in unconsolidated entities			34,408	3,960		38,368
Investment in non-performing loan portfolios and foreclosed real estate				(30,090)		(30,090)
Return of investments in non-performing loan portfolios and foreclosed real estate				16,707		16,707
Acquisition of a business			(144,746)			(144,746)
Intercompany advances	(43,383)	(584,260)			627,643	—
Net cash used in investing activities	(43,383)	(584,260)	(387,485)	(173,061)	627,643	(560,546)
Cash flow provided by financing activities:						
Net proceeds from issuance of senior notes		578,696				578,696
Proceeds from loans payable				1,002,934		1,002,934
Principal payments of loans payable			(28,402)	(987,679)		(1,016,081)
Proceeds from stock-based benefit plans	33,747					33,747
Excess tax benefits from stock-based compensation	5,776					5,776
Purchase of treasury stock	(505)					(505)
Intercompany advances			450,906	174,028	(624,934)	—
Net cash provided by financing activities	39,018	578,696	422,504	189,283	(624,934)	604,567
Net decrease in cash and cash equivalents	—	—	(64,988)	(62,528)	—	(127,516)
Cash and cash equivalents, beginning of year	—	—	777,012	129,328	—	906,340
Cash and cash equivalents, end of year	—	—	712,024	66,800	—	778,824

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Consolidating Statement of Cash Flows for the fiscal year ended October 31, 2011

	Toll Brothers, Inc.	Subsidiary Issuer	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated
Net cash provided by (used in) operating activities	100,568	5,279	(276,839)	229,737	8	58,753
Cash flow (used in) provided by investing activities:						
Purchase of property and equipment — net			(12,025)	(3,431)		(15,456)
Purchase of marketable securities			(452,864)			(452,864)
Sale and redemption of marketable securities			408,831			408,831
Investment in and advances to unconsolidated entities			(70)	(62)		(132)
Return of investments in unconsolidated entities			23,859	19,450		43,309
Investment in non-performing loan portfolios and foreclosed real estate				(66,867)		(66,867)
Return of investments in non-performing loan portfolios and foreclosed real estate				2,806		2,806
Intercompany advances	(76,997)	53,558			23,439	—
Net cash (used in) provided by investing activities	(76,997)	53,558	(32,269)	(48,104)	23,439	(80,373)
Cash flow (used in) provided by financing activities:						
Proceeds from loans payable				921,251		921,251
Principal payments of loans payable			(16,412)	(936,209)		(952,621)
Redemption of senior notes		(58,837)				(58,837)
Proceeds from stock-based benefit plans	25,531					25,531
Purchase of treasury stock	(49,102)					(49,102)
Change in noncontrolling interest				2,678		2,678
Intercompany advances			172,127	(148,680)	(23,447)	—
Net cash (used in) provided by financing activities	(23,571)	(58,837)	155,715	(160,960)	(23,447)	(111,100)
Net (decrease) increase in cash and cash equivalents	—	—	(153,393)	20,673	—	(132,720)
Cash and cash equivalents, beginning of year	—	—	930,405	108,655	—	1,039,060
Cash and cash equivalents, end of year	—	—	777,012	129,328	—	906,340

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20. Summary Consolidated Quarterly Financial Data (Unaudited)

The table below provides summary income statement data for each quarter of fiscal 2013 and 2012 (amounts in thousands, except per share data).

	Three Months Ended,			
	October 31	July 31	April 30	January 31
Fiscal 2013:				
Revenue	\$1,044,534	\$689,160	\$516,004	\$424,601
Gross profit	\$222,273	\$144,071	\$95,991	\$78,664
Income before income taxes	\$150,150	\$68,253	\$40,968	\$8,326
Net income	\$94,905	\$46,595	\$24,674	\$4,432
Income per share (1)				
Basic	\$0.56	\$0.28	\$0.15	\$0.03
Diluted	\$0.54	\$0.26	\$0.14	\$0.03
Weighted-average number of shares				
Basic	169,440	169,268	169,380	169,064
Diluted (2)	177,952	178,001	178,136	171,903
Fiscal 2012:				
Revenue	\$632,826	\$554,319	\$373,681	\$321,955
Gross profit	\$127,088	\$106,391	\$66,860	\$50,347
Income (loss) before income taxes	\$60,749	\$42,952	\$15,649	\$(6,408)
Net income (loss)	\$411,417	\$61,643	\$16,872	\$(2,786)
Income (loss) per share (1)				
Basic	\$2.44	\$0.37	\$0.10	\$(0.02)
Diluted	\$2.35	\$0.36	\$0.10	\$(0.02)
Weighted-average number of shares				
Basic	168,416	167,664	166,994	166,311
Diluted (2)	174,775	170,229	168,503	166,311

(1) Due to rounding, the sum of the quarterly earnings per share amounts may not equal the reported earnings per share for the year.

For the three months ended January 31, 2012, there were no common stock equivalents used in the calculation of (2) diluted loss per share because the Company reported a net loss for the period, and any common stock equivalents would be anti-dilutive.