SPLUNK INC
Form 10-Q
December 07, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(MARK ONE)

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

FOR THE QUARTERLY PERIOD ENDED OCTOBER 31, 2018

OR

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

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER 001-35498

SPLUNK INC.
(Exact name of registrant as specified in its charter)

Delaware	86-1106510
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

270 Brannan Street
San Francisco, California 94107
(Address of principal executive offices)
(Zip Code)

(415) 848-8400
(Registrant’s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data file required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). YES ý NO o

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

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o	Smaller reporting company o
Emerging growth company o	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES o NO ý

There were 147,783,032 shares of the registrant’s Common Stock issued and outstanding as of November 29, 2018.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

Splunk Inc.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share amounts)
(Unaudited)

	October 31, 2018	January 31, 2018 *As Adjusted
Assets		
Current assets		
Cash and cash equivalents	$1,868,116	$545,947
Investments, current	803,382	619,203
Accounts receivable, net	303,316	396,413
Prepaid expenses and other current assets	69,762	70,021
Deferred commissions, current	63,492	52,451
Total current assets	3,108,068	1,684,035
Investments, non-current	113,747	5,375
Property and equipment, net	156,502	160,880
Intangible assets, net	98,738	48,142
Goodwill	503,388	161,382
Deferred commissions, non-current	52,003	37,920
Other assets	107,228	41,711
Total assets	$4,139,674	$2,139,445
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	$18,669	$11,040
Accrued compensation	181,425	145,365
Accrued expenses and other liabilities	104,715	84,631
Deferred revenue, current	504,587	489,913
Total current liabilities	809,396	730,949
Convertible senior notes, net	1,614,945	—
Deferred revenue, non-current	197,992	178,792
Other liabilities, non-current	95,474	98,383
Total non-current liabilities	1,908,411	277,175
Total liabilities	2,717,807	1,008,124
Commitments and contingencies (Note 3)		
Stockholders' equity		
Common stock: $0.001 par value; 1,000,000,000 shares authorized; 147,783,032 shares issued and outstanding at October 31, 2018, and 142,835,123 shares issued and outstanding at January 31, 2018	148	143
Accumulated other comprehensive income (loss)	(4,583)	156
Additional paid-in capital	2,660,472	2,086,893
Accumulated deficit	(1,234,170)	(955,871)
Total stockholders' equity	1,421,867	1,131,321

Total liabilities and stockholders’ equity	$4,139,674	$2,139,445

* Prior-period information has been adjusted to reflect the adoption of ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which we adopted on February 1, 2018. Refer to Note 1 for further details.

The accompanying notes are an integral part of these condensed consolidated financial statements.

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Splunk Inc.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2018	2017 *As Adjusted	2018	2017 *As Adjusted
Revenues				
License	$279,603	$193,810	$619,246	$443,603
Maintenance and services	201,380	148,679	561,679	405,878
Total revenues	480,983	342,489	1,180,925	849,481
Cost of revenues (1)				
License	5,922	3,013	16,717	9,100
Maintenance and services	83,303	61,154	234,226	173,106
Total cost of revenues	89,225	64,167	250,943	182,206
Gross profit	391,758	278,322	929,982	667,275
Operating expenses (1)				
Research and development	117,722	74,080	310,818	217,152
Sales and marketing	264,223	198,266	726,089	558,364
General and administrative	59,819	35,857	168,405	111,492
Total operating expenses	441,764	308,203	1,205,312	887,008
Operating loss	(50,006)	(29,881)	(275,330)	(219,733)
Interest and other income (expense), net				
Interest income	8,571	2,403	15,322	6,273
Interest expense	(12,270)	(2,133)	(16,401)	(6,695)
Other income (expense), net	(186)	(289)	(657)	(1,771)
Total interest and other income (expense), net	(3,885)	(19)	(1,736)	(2,193)
Loss before income taxes	(53,891)	(29,900)	(277,066)	(221,926)
Income tax provision (benefit)	1,814	(232)	637	1,459
Net loss	$(55,705)	$(29,668)	$(277,703)	$(223,385)
Basic and diluted net loss per share	$(0.38)	$(0.21)	$(1.91)	$(1.61)
Weighted-average shares used in computing basic and diluted net loss per share	146,391	140,413	145,015	139,111

(1) Amounts include stock-based compensation expense, as follows:

Cost of revenues	$8,867	$7,921	$26,618	$24,523
Research and development	35,088	25,038	95,101	77,826
Sales and marketing	45,280	36,728	133,874	120,023
General and administrative	18,449	14,424	51,756	44,161

* Prior-period information has been adjusted to reflect the adoption of ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which we adopted on February 1, 2018. Refer to Note 1 for further details.

The accompanying notes are an integral part of these condensed consolidated financial statements.

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Splunk Inc.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(In thousands)
(Unaudited)

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2018	2017 *As Adjusted	2018	2017 *As Adjusted
Net loss	$(55,705)	$(29,668)	$(277,703)	$(223,385)
Other comprehensive gain (loss)				
Net unrealized gain (loss) on investments (net of tax)	(265)	(93)	442	(542)
Foreign currency translation adjustments	(1,588)	(632)	(5,181)	1,481
Total other comprehensive gain (loss)	(1,853)	(725)	(4,739)	939
Comprehensive loss	$(57,558)	$(30,393)	$(282,442)	$(222,446)

* Prior-period information has been adjusted to reflect the adoption of ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which we adopted on February 1, 2018. Refer to Note 1 for further details.

The accompanying notes are an integral part of these condensed consolidated financial statements.

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Splunk Inc.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended October 31,	
	2018	2017 *As Adjusted
Cash flows from operating activities		
Net loss	$(277,703)	$(223,385)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	37,946	30,039
Amortization of deferred commissions	55,592	32,809
Amortization of investment premiums (accretion of discounts)	(1,852)	373
Amortization of debt discount and issuance costs	8,491	—
Stock-based compensation	307,345	266,533
Deferred income taxes	(427)	(2,677)
Facility exit charge - adjustment	—	(5,191)
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable, net	100,873	(24,858)
Prepaid expenses and other assets	(62,784)	(8,501)
Deferred commissions	(80,716)	(44,464)
Accounts payable	6,771	4,919
Accrued compensation	36,577	15,626
Accrued expenses and other liabilities	10,498	2,574
Deferred revenue	28,475	73,036
Net cash provided by operating activities	169,086	116,833
Cash flows from investing activities		
Purchases of investments	(810,264)	(517,904)
Maturities of investments	525,126	514,010
Acquisitions, net of cash acquired	(394,910)	(59,350)
Purchases of property and equipment	(15,177)	(13,931)
Other investment activities	(5,119)	—
Net cash used in investing activities	(700,344)	(77,175)
Cash flows from financing activities		
Proceeds from the exercise of stock options	1,695	2,474
Proceeds from employee stock purchase plan	24,201	19,282
Proceeds from the issuance of convertible senior notes, net of issuance costs	2,106,225	—
Purchase of capped calls	(274,275)	—
Taxes paid related to net share settlement of equity awards	(779)	(88,651)
Repayment of financing lease obligation	(1,862)	(1,299)
Net cash provided by (used in) financing activities	1,855,205	(68,194)
Effect of exchange rate changes on cash and cash equivalents	(1,778)	504
Net increase (decrease) in cash and cash equivalents	1,322,169	(28,032)
Cash and cash equivalents at beginning of period	545,947	421,346
Cash and cash equivalents at end of period	$1,868,116	$393,314

	Nine Months Ended October 31, 2018	2017 *As Adjusted
Supplemental disclosures		
Cash paid for income taxes	$5,630	$ 4,948
Cash paid for interest expense related to financing lease obligation	6,161	6,068
Non-cash investing and financing activities		
Increase (decrease) in accrued purchases of property and equipment	(295)	463
Costs related to issuance of convertible senior notes included in accounts payable and accrued expenses and other liabilities	930	—

* Prior-period information has been adjusted to reflect the adoption of ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which we adopted on February 1, 2018. Refer to Note 1 for further details.

The accompanying notes are an integral part of these condensed consolidated financial statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(1) Description of the Business and Significant Accounting Policies

Business

Splunk Inc. (“we,” “us,” “our”) provides innovative software solutions that enable organizations to gain real-time operational intelligence by harnessing the value of their data. Our offerings enable users to collect, index, search, explore, monitor, correlate and analyze data regardless of format or source. Our offerings address large and diverse data sets commonly referred to as big data and are specifically tailored for machine data. Machine data is produced by nearly every software application and electronic device across an organization and contains a definitive, time-stamped record of various activities, such as transactions, customer and user behavior, and security threats. Our offerings help users derive new insights from machine data that can be used to, among other things, improve service levels, reduce operational costs, mitigate security risks, demonstrate and maintain compliance, and drive better business decisions. We were incorporated in California in October 2003 and reincorporated in Delaware in May 2006.

Fiscal Year

Our fiscal year ends on January 31. References to fiscal 2019 or fiscal year 2019, for example, refer to the fiscal year ending January 31, 2019.

Basis of Presentation

Effective February 1, 2018, we adopted the Accounting Standards Update (ASU) No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” as discussed in “Recently Adopted Accounting Standards” below. Disclosures in this Quarterly Report on Form 10-Q have been updated to comply with the new standards, as indicated by the “As Adjusted” reference in these condensed consolidated financial statements and related notes.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (“GAAP”) and applicable rules and regulations of the Securities and Exchange Commission (“SEC”) regarding interim financial reporting. Certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. The condensed consolidated balance sheet data as of January 31, 2018 was derived from audited financial statements as adjusted to reflect the impact of the full retrospective adoption of Topic 606; but does not include all disclosures required by GAAP. Therefore, these condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Annual Report on Form 10-K for the fiscal year ended January 31, 2018, filed with the SEC on March 30, 2018.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all normal recurring adjustments necessary to state fairly the financial position, results of operations, comprehensive loss and cash flows for the interim periods, but are not necessarily indicative of the results of operations to be anticipated for the full fiscal year 2019.

Reclassifications

Certain reclassifications have been made to prior year balances in order to conform to the current period presentation. “Interest income” and “Interest expense” have been reclassified from “Interest income (expense), net” on the condensed consolidated statements of operations. These reclassifications had no impact on the previously reported net loss or accumulated deficit.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates, judgments and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting periods covered by the financial statements and accompanying notes. In particular, we make estimates with respect to the stand-alone selling price for each distinct performance obligation included in customer contracts with multiple performance obligations, uncollectible accounts receivable, the assessment of the useful life and recoverability of long-lived assets (property and equipment, goodwill

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and identified intangibles), the period of benefit for deferred commissions, stock-based compensation expense, the fair value of assets acquired and liabilities assumed for business combinations, income taxes, leases and contingencies. Actual results could differ from those estimates.

Segments

We operate our business as one operating segment: the development and marketing of software solutions that enable our customers to gain real-time operational intelligence by harnessing the value of their data. Our chief operating decision maker is our Chief Executive Officer, who reviews financial information presented on a consolidated basis for purposes of making operating decisions, assessing financial performance and allocating resources.

Principles of Consolidation

The accompanying unaudited condensed consolidated financial statements include the accounts of Splunk Inc. and its direct and indirect wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated upon consolidation.

Revenue Recognition

We generate revenues primarily in the form of software license and related maintenance fees, cloud services and other services fees. Licenses for on-premises software are either perpetual or term licenses and provide the customer with a right to use the software. Typically, when purchasing a perpetual license, a customer also purchases one year of maintenance for which we charge a percentage of the license fee. When a term license is purchased, maintenance is bundled with the license for the term of the license period. Cloud services are provided on a subscription basis and give our customers access to our cloud solutions, which include related customer support. Other services include training and professional services that are not integral to the functionality of the licenses or cloud services.

Revenue from on-premises licenses is recognized upfront upon transfer of control of the software, which occurs at delivery, or when the license term commences, if later. We recognize revenue from maintenance contracts ratably over the service period. Cloud services revenue is recognized ratably over the cloud service term. Training and professional services are provided either on a time and material basis, in which revenues are recognized as services are delivered, or over a contractual term, in which revenues are recognized ratably. With respect to contracts that include customer acceptance provisions, we recognize revenue upon customer acceptance. Our policy is to record revenues net of any applicable sales, use or excise taxes.

Our contracts with customers often contain multiple performance obligations. For these contracts, we account for individual performance obligations separately if they are distinct. The transaction price is allocated to the separate performance obligations on a relative standalone selling price ("SSP") basis. We determine the SSP based on an observable standalone selling price when it is available, as well as other factors, including, the price charged to customers, our discounting practices, and our overall pricing objectives, while maximizing observable inputs. In situations where pricing is highly variable or uncertain, we estimate the SSP using a residual approach.

A receivable is recorded in the period we deliver products or provide services, or when we have an unconditional right to payment. Some of our multi-year on-premises license contracts are invoiced annually and we generally recognize the total amount of the license revenues upfront and record a corresponding receivable, if we have an unconditional right to receive payment. Current and non-current accounts receivable, net of allowance for doubtful accounts, was $378.0 million and $396.4 million as of October 31, 2018 and January 31, 2018, respectively.

Payment terms and conditions vary by contract type, although our terms generally include a requirement of payment within 30 to 60 days. In instances where the timing of revenue recognition differs from the timing of payment, we have determined our contracts do not include a significant financing component. The primary purpose of our invoicing terms is to provide customers with simplified and predictable ways of purchasing our products and services, not to receive financing from our customers or to provide customers with financing.

Deferred revenue is recorded when we invoice a contract prior to recognizing revenue. It is comprised mainly of balances related to maintenance and cloud services invoiced at the beginning of each service period. Deferred revenue also includes balances for training and professional services for which a payment has been received in advance of performance, as well as for licenses that we delivered prior to the license term commencing.

Deferred Sales Commissions

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Sales commissions paid to our sales force and the related payroll taxes are considered incremental and recoverable costs of obtaining a contract with a customer. These costs are capitalized and recorded in “Deferred commissions, current and non-current” in our condensed consolidated balance sheets. We generally amortize these costs over the remaining contractual term of our customer contracts, consistent with the pattern of revenue recognition of each performance obligation, for contracts in which the commissions paid on the initial and renewal contracts are commensurate. For certain contracts in which the commissions paid on the initial and renewal contracts are not commensurate, we amortize the commissions paid on the initial contract over an expected period of benefit, which we have determined to be approximately five years. We have determined the period of benefit by taking into consideration our customer contracts, the duration of our relationships with our customers and our technology. In capitalizing and amortizing deferred commissions, we have elected to apply a portfolio approach. We include amortization of deferred commissions in “Sales and marketing expense” in our condensed consolidated statements of operations. There were no impairments to deferred commissions for all periods presented.

Equity Investments

Equity investments without readily determinable fair values are accounted for at cost, less impairment and adjusted for subsequent observable price changes obtained from transactions for identical or similar investments issued by the same issuer. Changes in the basis of the equity investment will be recognized in “Other income (expense), net.”

Investments in entities where we have the ability to exercise significant influence, but not control, over the investee are accounted for using the equity method of accounting. Our results of operations will include, as a component of “Other income (expense), net,” our share of the net income or loss of the equity investments accounted for under the equity method of accounting.

Stock-Based Compensation

We recognize compensation expense for all share-based payment awards, including stock options, restricted stock units (“RSUs”), performance units (“PSUs”) and restricted stock awards (“RSAs”), based on the estimated fair value of the award on the grant date over the related vesting periods. The expense recorded is based on awards ultimately expected to vest and therefore is reduced by estimated forfeitures. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. We calculate the fair value of options using the Black-Scholes method and expense using the straight-line attribution approach.

We account for equity awards issued to non-employees, such as consultants, in accordance with the guidance relating to equity instruments that are issued to other than employees for acquiring, or in conjunction with selling, goods or services, using the Black-Scholes method to determine the fair value of such instruments.

The fair value of each option grant and stock purchase right granted under the Employee Stock Purchase Plan (“ESPP”) is estimated on the date of grant using the Black-Scholes option pricing model. We recognize stock-based compensation expense related to our ESPP on a straight-line basis over the offering period, which is twelve months. Stock-based compensation expense is recognized net of estimated forfeiture activity.

The determination of the grant date fair value of options using an option-pricing model is affected by assumptions regarding a number of other complex and subjective variables, which include our expected stock price volatility over the expected term of the options, stock option exercise and cancellation behaviors, risk-free interest rates and expected dividends.

The number of PSUs earned and eligible to vest are determined based on achievement of certain performance conditions and/or market conditions and the recipients' continued service with us. For awards subject to service and performance conditions, the number of shares of our stock issued pursuant to the award can range from 0% to 200% of the target amount. For awards subject to service and performance conditions that also include market conditions, the number of shares of our stock issued pursuant to the award can range from 0% to 300% of the target amount. Compensation expense for PSUs with performance conditions is measured using the fair value at the date of grant and recorded over the vesting period under the graded-vesting attribution method, and may be adjusted over the vesting period based on interim estimates of performance against the pre-set objectives. We use a Monte Carlo option-pricing model to determine the fair value of PSUs with market conditions.

Recently Adopted Accounting Standards

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In June 2018, the Financial Accounting Standards Board ("FASB") issued ASU No. 2018-07 (Topic 718), Compensation - Stock Compensation: Improvements to Nonemployee Share-Based Payment Accounting. Under the new standard, entities will no longer be required to value non-employee share-based payment awards differently from employee awards. Upon transition, entities are required to measure non-employee awards at their grant-date fair value as of the adoption date. We early adopted this new standard as of August 1, 2018. The adoption of this new standard did not have a material impact on our condensed consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09 (Topic 718), Scope of Modification Accounting. The new standard clarifies when changes to the terms or conditions of a share-based payment award must be accounted for as modifications. We adopted this new standard as of February 1, 2018. The adoption of this new standard did not have an impact on our condensed consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-01 (Topic 805), Business Combinations - Clarifying the Definition of a Business. The new standard narrows the application of when an integrated set of assets and activities is considered a business and provides a framework to assist entities in evaluating whether both an input and a substantive process are present to be considered a business. We adopted this new standard as of February 1, 2018, and anticipate that the adoption of the new guidance will result in more transactions being accounted for as asset acquisitions rather than business combinations and that the new standard will impact our consideration of strategic investments. The adoption of this new standard did not have an impact on our condensed consolidated financial statements.

In October 2016, the FASB issued ASU No. 2016-16 (Topic 740), Income Taxes: Intra-Entity Transfers of Assets Other Than Inventory, which includes a revision of the accounting for the income tax consequences of intra-entity transfers of assets other than inventory to reduce the complexity in accounting standards. We adopted this new standard as of February 1, 2018 with an immaterial cumulative effect adjustment recorded in accumulated deficit as of February 1, 2018.

In January 2016, the FASB issued ASU No. 2016-01 (Subtopic 825-10), Financial Instruments - Overall. The amendments in this update, and recent clarifications issued by the FASB through ASU No. 2018-03 and ASU No. 2018-04, address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments, and require equity securities to be measured at fair value with changes in fair value recognized through net income. We adopted this new standard as of February 1, 2018 on a prospective basis. As part of the adoption, we elected to apply the measurement alternative for our non-marketable equity investments that do not have readily determinable fair values, measuring them at cost, less any impairment, plus or minus adjustments resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. The adoption of these standards did not result in an adjustment for our non-marketable equity investments.

In May 2014, the FASB issued ASU No. 2014-09 (Topic 606), Revenue from Contracts with Customers, which supersedes the revenue recognition requirements in Accounting Standards Codification 605, Revenue Recognition and establishes a new revenue standard. This new standard is based on the principle that revenue is recognized to depict the transfer of control of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. The standard also requires additional disclosures about the nature, amount, timing and uncertainty of revenues and cash flows arising from customer contracts, including significant judgments and changes in judgments, and assets recognized from costs incurred to obtain or fulfill a contract. The FASB has also issued several amendments to the new standard which were designed to clarify and simplify the adoption process.

In preparation for adoption of the new standard, we updated our accounting policies, systems, internal controls and processes. We adopted Topic 606 as of February 1, 2018 using the full retrospective method, which required us to adjust our historical financial information for fiscal years 2017 and 2018 to be consistent with the new standard. The most significant impacts of the standard relate to the timing of revenue recognition for arrangements involving term licenses, deferred revenue and sales commissions. Under the new revenue standard, we are required to recognize term license revenues upon the transfer of the license and the associated maintenance revenues over the contract period. Additionally, some deferred revenue, primarily from arrangements involving term licenses, was never recognized as revenue and instead is now a part of the cumulative effect adjustment within accumulated deficit. Finally, we are required to capitalize and amortize incremental costs of obtaining a contract, such as certain sales commission costs, over the remaining contractual term or over an expected period of benefit, which we have determined to be approximately five years.

We applied the following practical expedients permitted under Topic 606. For all reporting periods presented before the date of initial adoption, we have elected not to disclose the amount of the transaction price allocated to the remaining performance obligations or provide an explanation of when we expect to recognize that amount as revenue. Additionally, we have also elected not to separately evaluate each contract modification that occurred before the initial adoption date. We have

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elected not to assess whether a contract has a significant financing component if we expect at contract inception that the period between payment and the transfer of products or services will be one year or less.

The following tables present the impact of the new revenue standard to the reported results on our selected condensed consolidated statements of operations data and condensed consolidated balance sheet data and (in thousands, except per share data):

Selected Condensed Consolidated Statements of Operations Data

	Three Months Ended October 31, 2017		
	As Reported	Impact of Adoption	As Adjusted
Revenues			
License	$179,829	$13,981	$193,810
Maintenance and services	148,824	(145)	148,679
Total revenues	328,653	13,836	342,489
Gross profit	264,486	13,836	278,322
Operating expenses			
Sales and marketing	205,364	(7,098)	198,266
Operating loss	(50,815)	20,934	(29,881)
Net loss	$(50,602)	$20,934	$(29,668)
Basic and diluted net loss per share	$(0.36)	$0.15	$(0.21)

	Nine Months Ended October 31, 2017		
	As Reported	Impact of Adoption	As Adjusted
Revenues			
License	$439,406	$4,197	$443,603
Maintenance and services	411,659	(5,781)	405,878
Total revenues	851,065	(1,584)	849,481
Gross profit	668,859	(1,584)	667,275
Operating expenses			
Sales and marketing	570,596	(12,232)	558,364
Operating loss	(230,381)	10,648	(219,733)
Net loss	$(234,033)	$10,648	$(223,385)
Basic and diluted net loss per share	$(1.68)	$0.07	$(1.61)

Selected Condensed Consolidated Balance Sheet Data

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	January 31, 2018		
	As Reported	Impact of Adoption	As Adjusted
Assets			
Accounts receivable, net	$391,799	$ 4,614	$396,413
Deferred commissions, current	—	52,451	52,451
Deferred commissions, non-current	—	37,920	37,920
Liabilities and Stockholders' Equity			
Accrued expenses and other liabilities	77,160	7,471	84,631
Deferred revenue, current	635,253	(145,340)	489,913
Deferred revenue, non-current	269,954	(91,162)	178,792
Accumulated deficit	(1,279,887)	324,016	(955,871)

The adoption of Topic 606 had no impact to cash provided by or used in operating, financing, or investing activities on our condensed consolidated statements of cash flows.

Recently Issued Accounting Pronouncements

In August 2018, the FASB issued ASU No. 2018-15 (Subtopic 350-40), Intangibles - Goodwill and Other - Internal-Use Software: Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract. The standard aligns the requirements for capitalizing implementation costs in a cloud computing arrangement service contract with the requirements for capitalizing implementation costs incurred for an internal-use software license. The standard is effective for our first quarter of fiscal 2021, although early adoption is permitted. We are currently evaluating whether the adoption of this standard will have a material impact on our condensed consolidated financial statements.

In August 2018, the FASB issued ASU No. 2018-13 (Topic 820), Fair Value Measurement: Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement. The standard no longer requires disclosure of the amount and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, but public companies will be required to disclose the range and weighted-average used to develop significant unobservable inputs for Level 3 fair value measurements. ASU No. 2018-13 is effective for our first quarter of fiscal 2020, although early adoption is permitted. We are currently evaluating whether the adoption of this standard will have a material impact on our condensed consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13 (Topic 326), Financial Instruments - Credit Losses. The amendments in this update require a financial asset (or a group of financial assets) measured at an amortized cost basis to be presented at the net amount expected to be collected. The new approach to estimating credit losses (referred to as the current expected credit losses model) applies to most financial assets measured at amortized cost and certain other instruments, including trade and other receivables, loans and held-to-maturity debt securities. In November 2018, the FASB issued ASU No. 2018-19, Codification Improvements to Topic 326, Financial Instruments - Credit Losses, which clarifies codification and corrects unintended application of the guidance. The standard is effective for our first quarter of fiscal 2021, although early adoption is permitted. We are currently evaluating whether the adoption of this standard will have a material impact on our condensed consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02 (Topic 842), Leases, which supersedes the lease recognition requirements in ASC Topic 840, Leases. The standard requires an entity to recognize right-of-use assets and lease liabilities arising from a lease for operating leases, initially measured at the present value of the lease payments on the condensed consolidated balance sheets. The impact of such leases on the condensed consolidated statements of operations and cash flows will continue to be treated in a similar manner under current GAAP. The standard also requires additional qualitative and quantitative disclosures. In July 2018, the FASB issued ASU No. 2018-10, Codification Improvements to Topic 842, Leases, which clarifies the codification or corrects unintended application of the guidance.

The new lease standard is effective in the first quarter of fiscal 2020 and may be applied retrospectively to each prior period presented or, as amended by ASU No. 2018-11, with the cumulative-effect recognized as of the date of initial application. We currently plan to adopt the standard using the cumulative effect transition method and although early adoption is permitted, we will not early adopt.

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We are continuing to evaluate the total impact of the new lease standard on our condensed consolidated financial statements, accounting policies, systems, processes and internal controls, and have allocated internal and external resources to assist in our implementation efforts. We are continuing to evaluate our existing population of contracts to ensure that all contracts that meet the definition of a lease under the new standard are identified. We anticipate that most of our office leases will be recognized as lease liabilities and corresponding right-of-use assets, and will accordingly have a material impact on our condensed consolidated balance sheets upon adoption.

(2) Investments and Fair Value Measurements

The carrying amounts of certain of our financial instruments including cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate fair value due to their short-term maturities.

Assets and liabilities recorded at fair value in the financial statements are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Hierarchical levels that are directly related to the amount of subjectivity associated with the inputs to the valuation of these assets or liabilities are as follows:

Level 1—Observable inputs, such as quoted prices in active markets for identical assets or liabilities.

Level 2—Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Assets and liabilities measured at fair value are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires management to make judgments and consider factors specific to the asset or liability.

The following table sets forth the fair value of our financial assets that were measured on a recurring basis as of October 31, 2018 and January 31, 2018 (in thousands):

	October 31, 2018				January 31, 2018			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets:								
Money market funds	$31,734	$ —	$ —	$31,734	$341,687	$ —	$ —	$341,687
U.S. treasury securities	—	974,554	—	974,554	—	619,203	—	619,203
Other	—	—	4,744	4,744	—	—	—	—
Reported as:								
Assets:								
Cash and cash equivalents				$99,653				$341,687
Investments, current				803,382				619,203
Investments, non-current				107,997				—
Total				$1,011,032				$960,890

Our investments in money market funds are measured at fair value on a recurring basis. These money market funds are actively traded and reported daily through a variety of sources. The fair value of the money market fund investments is classified as Level 1.

The following table represents our investments in U.S. treasury securities, which we have classified as available-for-sale investments as of October 31, 2018 (in thousands):

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	October 31, 2018			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Cash and cash equivalents:				
U.S. treasury securities	$67,924	$ —	$ (5)	$67,919
Investments, current:				
U.S. treasury securities	803,948	—	(566)	803,382
Investments, non-current:				
U.S. treasury securities	103,388	—	(135)	103,253
Total available-for-sale investments in U.S. treasury securities	$975,260	$ —	$ (706)	$974,554

The following table represents our investments in U.S. treasury securities, which we have classified as available-for-sale investments as of January 31, 2018 (in thousands):

	January 31, 2018			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Investments, current:				
U.S. treasury securities	$620,345	$ —	$ (1,142)	$619,203
Total available-for-sale investments in U.S. treasury securities	$620,345	$ —	$ (1,142)	$619,203

The following table represents the fair values and unrealized losses of our available-for-sale investments, classified by length of time that the securities have been in a continuous unrealized loss position (in thousands):

	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
October 31, 2018						
U.S. treasury securities	$974,554	$ (706)	$ —	$ —	$974,554	$ (706)
January 31, 2018						
U.S. treasury securities	$619,203	$ (1,142)	$ —	$ —	$619,203	$ (1,142)

As of October 31, 2018, we did not consider any of our investments to be other-than-temporarily impaired.

The contractual maturities of our investments are as follows (in thousands):

	October 31, 2018
Due within one year	$871,301
Due within one to two years	103,253
Total	$974,554

Investments with maturities of less than 12 months from the balance sheet date are classified as current assets, which are available for use to fund current operations. Investments with maturities greater than 12 months from the balance sheet date are classified as long-term assets.

Convertible Senior Notes

Refer to Note 7 “Convertible Senior Notes” for details regarding the fair value of our convertible senior notes.

Equity Investments

Our equity investments are reported in “Investments, non-current” on our condensed consolidated balance sheets. The following table provides a summary of our equity investments as of October 31, 2018 and January 31, 2018 (in thousands):

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	October 31, 2018	January 31, 2018
Equity investments without readily determinable fair values	$ 5,000	$ 5,000
Equity investments under the equity method of accounting	750	375
Total	$ 5,750	$ 5,375

(3) Commitments and Contingencies

Operating Lease Commitments

We lease our office spaces under non-cancelable leases. Rent expense, net of sublease income, for our operating leases was $6.3 million and $0.3 million for the three months ended October 31, 2018 and 2017, respectively. During the three months ended October 31, 2017, rent expense included a decrease of $5.2 million of expense in connection with a facility exit charge adjustment. Rent expense, net of sublease income, for our operating leases was $18.5 million and $10.8 million for the nine months ended October 31, 2018 and 2017, respectively.

On August 15, 2018, we entered into an office lease at 3060 Olsen Drive for approximately 301,000 square feet located in San Jose, California. This lease is expected to commence in fiscal 2020 for a term of 130 months, subject to the completion of certain pre-occupancy improvements by our landlord. Our total obligation for the base rent will be approximately $162.6 million.

On June 18, 2018, we renewed our office lease at 250 Brannan Street for approximately 101,000 square feet located in San Francisco, California. This lease is expected to commence in the first quarter of fiscal 2020 for a term of 147 months. Our total obligation for the base rent will be approximately $137.6 million.

The following summarizes our operating lease commitments as of October 31, 2018 (in thousands):

	Payments Due by Period				
	Total	Less Than 1 year	1-3 years	3-5 years	More Than 5 years
Operating lease commitments [1]	$469,227	$ 26,611	$ 93,566	$ 86,296	$ 262,754

[1] We have entered into sublease agreements for portions of our office space and the future rental income of $1.9 million from these agreements has been included as an offset to our future minimum rental payments.

Financing Lease Obligation

On April 29, 2014, we entered into an office lease (the “Lease”) for approximately 182,000 square feet located at 270 Brannan Street, San Francisco, California (the “Premises”). The Premises is allocated between the “Initial Premises” and “Additional Premises,” which are each approximately 91,000 square feet of rentable space. The term of the Additional Premises begins one year after the term of the Initial Premises, which began in August 2015, and each have a term of 84 months. Our total obligation for the base rent is approximately $92.0 million. On May 13, 2014, we entered into an irrevocable, standby letter of credit with Silicon Valley Bank for $6.0 million to serve as a security deposit for the Lease.

As a result of our involvement during the construction period, whereby we had certain indemnification obligations related to the construction, we were considered, for accounting purposes only, the owner of the construction project under build-to-suit lease accounting. We have recorded project construction costs incurred by the landlord as an asset and a corresponding long-term liability in “Property and equipment, net” and “Other liabilities, non-current,” respectively, on our condensed consolidated balance sheets. We moved into the Premises in February 2016. We have determined that the Lease does not meet the criteria for “sale-leaseback” treatment, due to our continuing involvement in the construction project resulting from our standby letter of credit. Accordingly, the Lease will continue to be accounted for as a financing obligation.

As of October 31, 2018, future payments on the financing lease obligation are as follows (in thousands):

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Fiscal Period:	
Remaining three months of fiscal 2019	$3,144
Fiscal 2020	12,928
Fiscal 2021	13,316
Fiscal 2022	13,715
Fiscal 2023	14,127
Thereafter	8,142
Total future minimum lease payments	$65,372

Legal Proceedings

We are subject to certain routine legal and regulatory proceedings, as well as demands and claims that arise in the normal course of our business. We make a provision for a liability relating to legal matters when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impact of negotiations, estimated settlements, legal rulings, advice of legal counsel and other information and events pertaining to a particular matter. In our opinion, resolution of any pending claims (either individually or in the aggregate) is not expected to have a material adverse impact on our condensed consolidated results of operations, cash flows or financial position, nor is it possible to provide an estimated amount of any such loss. However, depending on the nature and timing of any such dispute, an unfavorable resolution of a matter could materially affect our future results of operations or cash flows, or both, in a particular quarter.

Indemnification Arrangements

During the ordinary course of business, we may indemnify, hold harmless and agree to reimburse for losses suffered or incurred, our customers, vendors and each of their affiliates for certain intellectual property infringement and other claims by third parties with respect to our offerings, in connection with our commercial license arrangements or related to general business dealings with those parties.

As permitted under Delaware law, we have entered into indemnification agreements with our officers, directors and certain employees, indemnifying them for certain events or occurrences while they serve as our officers or directors or those of our direct and indirect subsidiaries.

To date, there have not been any costs incurred in connection with such indemnification obligations; therefore, there is no accrual of such amounts as of October 31, 2018. We are unable to estimate the maximum potential impact of these indemnifications on our future results of operations.

(4) Property and Equipment

Property and equipment are stated at cost, net of accumulated depreciation and amortization. These assets are depreciated and amortized using the straight-line method over their estimated useful lives. Property and equipment consisted of the following as of October 31, 2018 and January 31, 2018 (in thousands):

	As of October 31, 2018	January 31, 2018
Computer equipment and software	$77,800	$69,457
Furniture and fixtures	18,275	18,090
Leasehold and building improvements [1]	73,411	67,348
Building [2]	82,250	82,250

Property and equipment, gross	251,736	237,145
Less: accumulated depreciation and amortization	(95,234)	(76,265)
Property and equipment, net	$156,502	$160,880

[1] Includes costs related to assets not yet placed into service of $9.9 million and $2.8 million, as of October 31, 2018 and January 31, 2018, respectively.

(2) This relates to the capitalization of construction costs in connection with our financing lease obligation, where we are considered the owner of the asset, for accounting purposes only. There is a corresponding long-term liability for this obligation on our condensed consolidated balance sheets under “Other liabilities, non-current.” Refer to Note 3 “Commitments and Contingencies” for details.

Depreciation and amortization expense on property and equipment was $6.7 million and $6.5 million for the three months ended October 31, 2018 and 2017, respectively, and $19.8 million and $19.5 million for the nine months ended October 31, 2018 and 2017, respectively.

(5) Acquisitions, Goodwill and Intangible Assets

VictorOps

On June 22, 2018, we acquired 100% of the voting equity interest of VictorOps, Inc. (“VictorOps”), a privately-held Delaware corporation that develops incident management solutions for the IT and DevOps markets. This acquisition has been accounted for as a business combination. The purchase price of $112.3 million, paid in cash of $108.8 million and $3.5 million in fair value of replacement equity awards attributable to pre-acquisition service, was preliminarily allocated as follows: $21.1 million to identified intangible assets, $1.7 million to net assets acquired, with the excess $89.5 million of the purchase price over the fair value of net tangible and intangible assets acquired recorded as goodwill, allocated to our one operating segment. Goodwill is primarily attributable to the value expected from the synergies of the combination, including combined selling opportunities with our products. This goodwill is not deductible for income tax purposes. The results of operations of VictorOps, which are not material, have been included in our condensed consolidated financial statements from the date of purchase. Additionally, we recognized $2.7 million of acquisition-related costs as general and administrative expense on our condensed consolidated statements of operations.

Per the terms of the merger agreement with VictorOps, certain unvested stock options held by VictorOps employees were canceled and exchanged for replacement stock options to purchase shares of our common stock under our 2012 Equity Incentive Plan. Additionally, certain shares of stock issued under share-based compensation awards held by key employees of VictorOps were canceled and exchanged for unregistered restricted shares of our common stock subject to vesting. The portion of the fair value of the replacement equity awards associated with pre-acquisition service of VictorOps employees represented a component of the total purchase consideration, as discussed above. The remaining fair value of $7.6 million of these issued awards, which are subject to the recipients’ continued service with us and was excluded from the purchase price, will be recognized ratably as stock-based compensation expense over the required service period. We are still finalizing the allocation of the purchase price, which is subject to change as additional information becomes available to us.

The following table sets forth the components of identifiable intangible assets acquired and their estimated useful lives as of the date of acquisition (in thousands, except useful life):

	Fair Value	Useful Life (months)
Developed technology	$11,700	84
Customer relationships	9,400	60
Total intangible assets acquired	$21,100	

Phantom

On April 6, 2018, we acquired 100% of the voting equity interest of Phantom Cyber Corporation (“Phantom”), a privately-held Delaware corporation that develops solutions for security orchestration, automation and response. This acquisition has been accounted for as a business combination. The purchase price of $303.8 million, paid in cash of $291.5 million and $12.3 million in fair value of replacement equity awards attributable to pre-acquisition service, was preliminarily allocated as follows: $44.1 million to identified intangible assets, $10.5 million to net assets acquired, $3.3 million to net deferred tax liability, with the excess $252.5 million of the purchase price over the fair value of net tangible and intangible assets acquired recorded as goodwill, allocated to our one operating segment. Goodwill is primarily attributable to the value expected from the synergies of the combination, including combined selling opportunities with our products. This goodwill is not deductible for income tax purposes. The results of operations of Phantom, which are not material, have been included in our condensed consolidated financial statements from the date of purchase. Additionally, we recognized $3.3 million of acquisition-related costs as general and administrative expense on our condensed consolidated statements of operations.

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Per the terms of the merger agreement with Phantom, certain shares of stock issued under share-based compensation awards held by key employees of Phantom were canceled and exchanged for replacement equity awards consisting of unregistered restricted shares of our common stock subject to vesting. The portion of the fair value of the replacement equity awards associated with pre-acquisition service of Phantom's key employees represented a component of the total purchase consideration, as discussed above. The remaining fair value of $62.2 million of these issued awards, which are subject to the recipients' continued service with us and thus excluded from the purchase price, will be recognized ratably as stock-based compensation expense over the required service period. We are still finalizing the allocation of the purchase price, which is subject to change as additional information becomes available to us.

The following table sets forth the components of identifiable intangible assets acquired and their estimated useful lives as of the date of acquisition (in thousands, except useful life):

	Fair Value	Useful Life (months)
Developed technology	$34,400	84
Customer relationships	9,700	60
Total intangible assets acquired	$44,100	

Unaudited Pro Forma Financial Information

The following unaudited pro forma information presents the combined results of operations as if the acquisitions of VictorOps and Phantom had been completed on February 1, 2017, the beginning of the comparable prior annual reporting period. The unaudited pro forma results include adjustments primarily related to the following: (i) amortization associated with preliminary estimates for the acquired intangible assets; (ii) recognition of post-acquisition stock-based compensation; (iii) acquisition-related costs incurred prior to the acquisitions and (iv) the associated tax impact of the acquisitions and these unaudited pro forma adjustments.

The unaudited pro forma results do not reflect any cost saving synergies from operating efficiencies or the effect of the incremental costs incurred from integrating these companies. Accordingly, these unaudited pro forma results are presented for informational purposes only and are not necessarily indicative of what the actual results of operations of the combined company would have been if the acquisitions had occurred at the beginning of the period presented, nor are they indicative of future results of operations (in thousands, except per share amounts):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2018	2017	2018	2017
Revenue	$480,983	$346,632	$1,189,544	$861,390
Net loss	$(55,705)	$(43,693)	$(290,112)	$(265,494)
Basic and diluted net loss per share	$(0.38)	$(0.31)	$(2.00)	$(1.91)

Rocana

On October 6, 2017, we acquired certain assets of Rocana, Inc. ("Rocana"), a privately-held Delaware corporation that develops analytics solutions for the IT market. This acquisition has been accounted for as a business combination. The purchase price of $30.2 million, paid in cash, was allocated as follows: $10.1 million to identifiable intangible assets, with the excess $20.1 million of the purchase price over the fair value of net assets acquired recorded as goodwill. This goodwill is primarily attributable to the value expected from the synergies of the combination, including advancing the analytics and machine learning capabilities of our products, and is deductible for income tax purposes. The results of operations of the acquired entity, which are not material, have been included in our condensed consolidated financial statements from the date of purchase. Pro forma and historical results of operations of the acquired entity have not been presented as we do not consider the results to have a material effect on any of the periods presented in our condensed consolidated statements of operations.

The following table sets forth the components of identifiable intangible assets acquired and their estimated useful lives as of the date of acquisition (in thousands, except useful life):

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	Fair Value	Useful Life (months)
Developed technology	$8,320	36
Other acquired intangible assets	1,790	24
Total intangible assets acquired	$10,110	

SignalSense

On September 29, 2017, we acquired 100% of the voting equity interest of SignalSense Inc. (“SignalSense”), a privately held Washington corporation that develops cloud-based data collection and breach detection solutions that leverage machine learning. This acquisition has been accounted for as a business combination. The purchase price of $12.2 million, paid in cash, was allocated as follows: $11.3 million to identifiable intangible assets acquired, $0.2 million in net assets and $2.0 million to net deferred tax liabilities, with the excess $2.7 million of the purchase price over the fair value of net assets acquired recorded as goodwill. This goodwill is primarily attributable to the value expected from the synergies of the combination, including developing more advanced cloud and machine learning capabilities for our products, and is not deductible for income tax purposes. The results of operations of the acquired entity, which are not material, have been included in our condensed consolidated financial statements from the date of purchase. Pro forma and historical results of operations of the acquired entity have not been presented as we do not consider the results to have a material effect on any of the periods presented in our condensed consolidated statements of operations.

The following table sets forth the components of identifiable intangible assets acquired and their estimated useful lives as of the date of acquisition (in thousands, except useful life):

	Fair Value	Useful Life (months)
Developed technology	$11,310	36
Total intangible assets acquired	$11,310	

Drastin

On May 15, 2017, we acquired 100% of the voting equity interest of Drastin, Inc. (“Drastin”), a privately-held Delaware corporation that develops technology for search-driven analytics on enterprise data. This acquisition has been accounted for as a business combination. The purchase price of $17.3 million, paid in cash, was allocated as follows: $3.8 million to identifiable intangible assets and $0.5 million to net deferred tax liability, with the excess $14.0 million of the purchase price over the fair value of net assets acquired recorded as goodwill. This goodwill is primarily attributable to the value expected from the synergies of the combination, including developing a more intuitive search experience for our products, and is not deductible for income tax purposes. The results of operations of the acquired entity, which are not material, have been included in our condensed consolidated financial statements from the date of purchase. Pro forma and historical results of operations of the acquired entity have not been presented as we do not consider the results to have a material effect on any of the periods presented in our condensed consolidated statements of operations.

The following table sets forth the components of identifiable intangible assets acquired and their estimated useful lives as of the date of acquisition (in thousands, except useful life):

	Fair Value	Useful Life (months)
Developed technology	$3,500	48
Other acquired intangible assets	300	24
Total intangible assets acquired	$3,800	

Goodwill

There were no impairments to goodwill during the three or nine months ended October 31, 2018 or during prior periods. Goodwill balances are presented below (in thousands):

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	Carrying Amount
Balance as of January 31, 2018	$161,382
Goodwill acquired	342,006
Balance as of October 31, 2018	$503,388

Intangible Assets

Intangible assets subject to amortization realized from acquisitions as of October 31, 2018 are as follows (in thousands, except useful life):

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted-Average Remaining Useful Life (months)
Developed technology	$132,100	$ (51,681)	$80,419	54
Customer relationships	20,910	(3,568)	17,342	55
Other acquired intangible assets	3,270	(2,293)	977	12
Total intangible assets subject to amortization	$156,280	$ (57,542)	$98,738	

Amortization expense from acquired intangible assets was $7.1 million and $3.6 million for the three months ended October 31, 2018 and 2017, respectively, and $18.1 million and $10.5 million for the nine months ended October 31, 2018 and 2017, respectively.

The expected future amortization expense for acquired intangible assets as of October 31, 2018 is as follows (in thousands):

Fiscal Period:	
Remaining three months of fiscal 2019	$7,149
Fiscal 2020	27,909
Fiscal 2021	23,780
Fiscal 2022	13,701
Fiscal 2023	10,406
Thereafter	15,793
Total amortization expense	$98,738

(6) Debt Financing Facilities

On May 9, 2013, we entered into a Loan Agreement with Silicon Valley Bank, which provided us with a revolving line of credit facility. Under the agreement, we could borrow up to $25.0 million with interest accrued either at the prime rate or the LIBOR rate plus 2.75%. We never borrowed under the credit facility, and during the three months ended October 31, 2018, we terminated our Loan Agreement with Silicon Valley Bank.

(7) Convertible Senior Notes

In September 2018, we issued $1.27 billion aggregate principal amount of 0.50% Convertible Senior Notes due 2023 (the “2023 Notes”), including the exercise in full by the initial purchasers of the 2023 Notes of their option to purchase an additional $165.0 million principal amount of 2023 Notes, and $862.5 million aggregate principal amount of 1.125% Convertible Senior Notes due 2025 (the “2025 Notes” and, together with the 2023 Notes, the “Notes”), including the exercise in full by the initial purchasers of the 2025 Notes of their option to purchase an additional $112.5 million principal amount of 2025 Notes. The Notes are general senior, unsecured obligations of Splunk. The total proceeds from the issuance of the Notes was $2.11 billion, net of initial purchaser discounts and issuance costs.

The 2023 Notes will mature on September 15, 2023, and the 2025 Notes will mature on September 15, 2025, in each case unless earlier redeemed, repurchased or converted. The 2023 Notes will bear interest from September 21, 2018 at a rate of

0.50% per year and the 2025 Notes will bear interest from September 21, 2018 at a rate of 1.125% per year, in each case payable semiannually in arrears on March 15 and September 15 of each year, beginning on March 15, 2019.

The initial conversion rate for each series of notes is 6.7433 shares of our common stock per $1,000 principal amount of Notes, which is equivalent to an initial conversion price of approximately $148.30 per share of our common stock, subject to adjustment upon the occurrence of specified events. The initial conversion price of each series of Notes represents a premium of approximately 27.5% to the $116.31 per share closing price of our common stock on September 18, 2018, which was the date the pricing of the Notes was determined. The Notes will be convertible at the option of the holders at any time prior to the close of business on the business day immediately preceding June 15, 2023, in the case of the 2023 Notes, or June 15, 2025, in the case of the 2025 Notes, only under the following circumstances:

- during any fiscal quarter commencing after the fiscal quarter ending on January 31, 2019 (and only during such fiscal quarter), if the last reported sale price of our common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on, and including, the last trading day of the immediately preceding fiscal quarter is greater than or equal to 130% of the conversion price for the relevant series of Notes on each applicable trading day;

- during the five business day period after any 10 consecutive trading day period (the “measurement period”) in which the trading price (as defined in the indenture governing the relevant series of notes) per $1,000 principal amount of the relevant series of Notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of our common stock and the conversion rate for the relevant series of Notes on each such trading day;

- if we call the relevant series of Notes for redemption, at any time prior to the close of business on the scheduled trading day immediately preceding the redemption date; or

- upon the occurrence of specified corporate events as set forth in the relevant indenture.

On or after June 15, 2023, in the case of the 2023 Notes, and on or after June 15, 2025, in the case of the 2025 Notes, until the close of business on the second scheduled trading day immediately preceding the relevant maturity date, holders of the relevant series of Notes may convert all or any portion of their Notes of such series, in multiples of $1,000 principal amount, at the option of the holder regardless of the foregoing circumstances.

Upon conversion, we may satisfy our conversion obligation by paying and/or delivering, as the case may be, cash, shares of our common stock or a combination of cash and shares of our common stock, at our election, in the manner and subject to the terms and conditions provided in the relevant indenture. It is our current intent to settle the conversions of principal amount of the Notes in cash and the remaining conversion value, if any, in shares of common stock. If we undergo a fundamental change (as defined in each indenture), holders may require us to repurchase for cash all or any portion of their Notes of the relevant series at a fundamental change repurchase price equal to 100% of the principal amount of the relevant series of Notes to be repurchased, plus accrued and unpaid interest to, but excluding, the fundamental change repurchase date. In addition, following certain corporate events that occur prior to the relevant maturity date of a series of Notes or if we deliver a notice of redemption in respect of a series of Notes, we will, in certain circumstances, increase the conversion rate of the relevant series of Notes for a holder who elects to convert its Notes of the applicable series in connection with such corporate event or notice of redemption, as the case may be. During the three months ended October 31, 2018, the conditions allowing holders of the Notes to convert were not met. The Notes were therefore not convertible during the three months ended October 31, 2018 and were classified as long-term debt on our condensed consolidated balance sheets.

We may not redeem the 2023 Notes prior to September 20, 2021, and we may not redeem the 2025 Notes prior to September 20, 2022. We may redeem for cash all or any portion of the 2023 Notes, at our option, on or after September 20, 2021, and we may redeem for cash all or any portion of the 2025 Notes, at our option, on or after September 20, 2022, in each case if the last reported sale price of our common stock has been at least 130% of the conversion price for the relevant series of Notes then in effect for at least 20 trading days (whether or not consecutive) during any 30 consecutive trading day period (including the last trading day of such period) ending on, and including, the trading day immediately preceding the date on which we provide notice of redemption at a redemption price equal to 100% of the principal amount of the relevant series of Notes to be redeemed, plus accrued and unpaid interest to, but excluding, the relevant redemption date.

In accounting for the issuance of the Notes, we separated the Notes into liability and equity components. The carrying amounts of the liability components of the Notes were calculated by measuring the fair value of similar debt instruments that do not have an associated convertible feature. The carrying amounts of the equity components, representing the conversion

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option, were determined by deducting the fair value of the liability components from the par value of the respective Notes. This difference represents the debt discount that is amortized to interest expense over the respective terms of the Notes using the effective interest rate method. The carrying amounts of the equity components representing the conversion options were $266.9 million and $237.2 million for the 2023 Notes and 2025 Notes, respectively, and are recorded in additional paid-in capital and are not remeasured as long as they continue to meet the conditions for equity classification.

In accounting for the issuance costs related to the Notes, we allocated the total amount incurred to the liability and equity components of the Notes based on the proportion of the proceeds allocated to the debt and equity components. Issuance costs attributable to the liability component of the 2023 Notes and 2025 Notes were $10.4 million and $6.5 million, respectively. The issuance costs allocated to the liability component are amortized to interest expense over the contractual terms of the 2023 Notes and 2025 Notes at an effective interest rate of 5.65% and 6.22%, respectively. Issuance costs attributable to the equity component of the 2023 Notes and 2025 Notes were $2.8 million and $2.5 million, respectively, and are netted against the equity components representing the conversion option in additional paid-in capital.

The net carrying amount of the liability and equity components for each of the Notes as of October 31, 2018 was as follows (in thousands):

	2023 Notes	2025 Notes
Liability component:		
Principal amount	$1,265,000	$862,500
Unamortized discount	(261,748)	(234,148)
Unamortized issuance costs	(10,216)	(6,443)
Net carrying amount	$993,036	$621,909
Equity component, net of purchase discounts and issuance costs	$264,129	$234,712

The following table sets forth the interest expense related to the Notes (in thousands):

	Three and Nine Months Ended October 31, 2018	2017
2023 Notes:		
Coupon interest expense	$685	$ —
Amortization of debt discount (conversion option)	5,167	—
Amortization of debt issuance costs and purchase discounts	202	—
Total interest expense related to the 2023 Notes	$6,054	$ —
2025 Notes:		
Coupon interest expense	$1,051	$ —
Amortization of debt discount (conversion option)	3,039	—
Amortization of debt issuance costs and purchase discounts	84	—
Total interest expense related to the 2025 Notes	$4,174	$ —

As of October 31, 2018, the total estimated fair values of the 2023 Notes and the 2025 Notes were approximately $1.21 billion and $810.7 million, respectively. The fair value was determined based on the closing trading price per $100 of the Notes as of the last day of trading for the period. The fair value of the Notes is primarily affected by the trading price of our common stock and market interest rates. The fair value of the Notes is considered a Level 2 measurement as they are not actively traded.

Capped Calls

In connection with the issuance of the Notes, including the initial purchasers' exercise of the option to purchase additional Notes, we entered into privately negotiated capped call transactions with certain counterparties (the "Capped Calls"). The Capped Calls are expected to reduce potential dilution to our common stock upon conversion of the Notes and/or offset any cash payments that we are required to make in excess of the principal amount of converted Notes, as the case may be, with

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such reduction and/or offset subject to a cap. The Capped Calls have an initial strike price of $148.30 per share, subject to certain adjustments, which corresponds to the conversion option strike price in the Notes. The Capped Calls have a cap price equal to $232.62 per share, subject to certain adjustments. The Capped Calls are subject to adjustment upon the occurrence of specified extraordinary events affecting us, including merger events, tender offers and announcement events. In addition, the Capped Calls are subject to certain specified additional disruption events that may give rise to a termination of the Capped Calls, including nationalization, insolvency or delisting, changes in law, failures to deliver, insolvency filings and hedging disruptions. For accounting purposes, the Capped Calls are separate transactions, and not part of the terms of the Notes. As these transactions meet certain accounting criteria, the Capped Calls are recorded in stockholders' equity and are not accounted for as derivatives. The premium paid for the purchase of the Capped Calls in the amount of $274.3 million has been recorded as a reduction to additional paid-in capital and will not be remeasured.

(8) Stock Compensation Plans

The following table summarizes our stock option, RSU and PSU award activity during the nine months ended October 31, 2018:

		Options Outstanding				RSUs and PSUs Outstanding
	Shares Available for Grant	Shares	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value [1] (in thousands)	Shares
Balances as of January 31, 2018	14,658,992	623,120	$ 8.22	3.68	$ 52,435	13,016,473
Additional shares authorized	7,141,756					
Options granted	(54,343)	54,343	22.71			
Options exercised	—	(231,663)	7.32		23,433	
Options forfeited and expired	1,127	(1,127)	23.33			
RSUs and PSUs granted	(3,440,631)					3,440,631
RSUs and PSUs vested	—					(3,530,792)
Shares withheld related to net share settlement of RSUs and PSUs	39					—
RSUs and PSUs forfeited and canceled	813,479					(813,479)
Balances as of October 31, 2018	19,120,419	444,673	$ 10.42	3.60	$ 39,773	12,112,833
Vested and expected to vest		444,596	$ 10.41	3.60	$ 39,770	11,722,849
Exercisable as of October 31, 2018		402,518	$ 9.19	3.09	$ 36,487	

[1] The intrinsic value is calculated as the difference between the exercise price of the underlying stock option award and the closing market price of our common stock as of October 31, 2018.

Beginning in fiscal 2016, we have granted PSUs to certain executives under our 2012 Equity Incentive Plan. The number of PSUs earned and eligible to vest are determined based on achievement of certain performance conditions and/or market conditions and the recipients' continued service with us. For awards subject to service and performance conditions, the number of shares of our stock issued pursuant to the award can range from 0% to 200% of the target amount. For awards subject to service and performance conditions that also include market conditions, the number of shares of our stock issued pursuant to the award can range from 0% to 300% of the target amount.

As of October 31, 2018, total unrecognized compensation cost related to stock options was $3.3 million, adjusted for estimated forfeitures, which is expected to be recognized over a weighted-average period of 1.3 years. As of October 31, 2018, total unrecognized compensation cost was $678.9 million related to RSUs, adjusted for estimated forfeitures, which is expected to be recognized over the next 2.7 years. As of October 31, 2018, total unrecognized compensation cost was $42.9 million related to PSUs, adjusted for estimated forfeitures, which is expected to be recognized over the next 2.4 years.

The weighted-average grant date fair value of RSUs granted was $111.23 per share during the nine months ended October 31, 2018. The weighted-average grant date fair value of PSUs granted was $86.55 per share during the nine months ended October 31, 2018.

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The following table summarizes our RSA activity during the nine months ended October 31, 2018:

	Shares
Outstanding as of January 31, 2018	63,353
RSAs granted	824,605
RSAs vested	(11,225)
Outstanding as of October 31, 2018	876,733

The weighted-average grant date fair value of RSAs granted was $79.07 per share during the nine months ended October 31, 2018. As of October 31, 2018, total unrecognized compensation cost related to RSAs was $48.5 million, adjusted for estimated forfeitures, which is expected to be recognized over the next 2.1 years.

(9) Deferred Revenue and Remaining Performance Obligations

Deferred Revenue

Revenues recognized from amounts included in deferred revenue as of January 31, 2018 were $382.0 million during the nine months ended October 31, 2018.

Remaining Performance Obligations

Revenue allocated to remaining performance obligations represents contracted revenue that has not yet been recognized, which includes deferred revenue and non-cancelable amounts that will be invoiced and excludes performance obligations that are subject to cancellation terms. Our remaining performance obligations were $949.6 million as of October 31, 2018, of which we expect to recognize approximately 88% as revenue over the next 24 months and the remainder thereafter.

Disaggregation of Revenues

Refer to Note 10 “Geographic Information” for details regarding disclosures on the disaggregation of revenues.

(10) Geographic Information

Revenues

Revenues by geography are based on the shipping address of the customer. The following table presents our revenues by geographic region for the periods presented (in thousands):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2018	2017*	2018	2017*
United States	$364,626	$251,519	$859,268	$613,554
International	116,357	90,970	321,657	235,927
Total revenues	$480,983	$342,489	$1,180,925	$849,481

*Prior-period information has been adjusted to reflect the adoption of ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which we adopted on February 1, 2018. Refer to Note 1 for further details.

Other than the United States, no other individual country exceeded 10% of total revenues during any of the periods presented. One channel partner represented 30% of total revenues for each of the three months ended October 31, 2018 and 2017, and approximately 31% and 30% of total revenues during the nine months ended October 31, 2018 and 2017, respectively. A second channel partner represented approximately 23% and 24% of total revenues during the three months ended October 31, 2018 and 2017, respectively, and approximately 19% and 20% of total revenues during the nine months ended October 31, 2018 and 2017, respectively. The revenues from these channel partners are comprised of a number of customer transactions, none of which were individually greater than 10% of total revenues for the three or nine months ended October 31, 2018 or 2017.

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As of October 31, 2018, one channel partner represented 25% and a second channel partner represented 24% of total current and non-current accounts receivable. As of January 31, 2018, one channel partner represented 39% and a second channel partner represented 10% of total current and non-current accounts receivable.

Property and Equipment

The following table presents our property and equipment, net of depreciation and amortization, by geographic region as of October 31, 2018 and January 31, 2018 (in thousands):

	As of October 31, 2018	January 31, 2018
United States	$ 145,669	$ 153,335
International	10,833	7,545
Total property and equipment, net	$ 156,502	$ 160,880

Other than the United States, no other country represented 10% or more of our total property and equipment as of October 31, 2018 or January 31, 2018.

(11) Income Taxes

For the three months ended October 31, 2018 and 2017, we recorded income tax expense of $1.8 million and an income tax benefit of $0.2 million, respectively. The increase in income tax expense for the three months ended October 31, 2018 was primarily due to the partial release of the valuation allowance as a result of an acquisition during the three months ended October 31, 2017. For the nine months ended October 31, 2018 and 2017, we recorded income tax expense of $0.6 million and $1.5 million, respectively. The decrease in income tax expense for the nine months ended October 31, 2018 was primarily due to an increase in excess tax benefits partially offset by an increase in foreign taxes.

During the three months ended October 31, 2018, we released $122.6 million of the valuation allowance with an offsetting entry to additional paid-in capital as a result of our convertible senior notes offering.

During the three months ended October 31, 2018, there were no material changes to our unrecognized tax benefits. During fiscal year 2018, we recorded an increase to unrecognized tax benefits with an offset to the valuation allowance for $6.0 million relating to a change in accounting method for tax purposes. During the period ended April 30, 2018, we filed an application to formally change the accounting method with the IRS and received audit protection. As such, a reversal of the unrecognized tax benefits of $6.0 million was recorded with an offset to the valuation allowance during the period ended April 30, 2018. We do not expect to have any significant changes to unrecognized tax benefits within the next 12 months. Because of our history of tax losses, all years remain open to tax audit.

Tax Cuts and Jobs Act of 2017

In December 2017, the SEC staff issued Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act (“SAB 118”), which allows us to record provisional amounts for the 2017 Tax Cuts and Jobs Act (the “Tax Act”) during a measurement period not to extend beyond one year of the enactment date, with further clarifications made recently with the issuance of ASU No. 2018-05, Income Taxes (Topic 740): Amendments to SEC Paragraphs Pursuant to SEC SAB 118. Through October 31, 2018, we did not have any significant adjustments to our provisional amounts. We will continue our analysis of these provisional amounts, which are still subject to change during the measurement period. We anticipate further guidance on accounting interpretations from the FASB and application of the law from the Department of Treasury. We expect to reach a final determination within the measurement period described above.

The FASB Staff Q&A, Topic 740, No. 5, Accounting for Global Intangible Low-Taxed Income ("GILTI"), states that an entity can make an accounting policy election to either recognize deferred taxes for temporary basis differences expected to reverse as GILTI in future years or provide for the tax expense related to GILTI in the year the tax is incurred as a period expense. Given the complexity of the GILTI provisions, we are still evaluating the effects of the GILTI provisions and have not yet determined our accounting policy.

(12) Net Loss Per Share

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Basic net loss per share is computed by dividing the net loss by the weighted-average number of shares of common stock outstanding during the period, less the weighted-average unvested common stock subject to repurchase or forfeiture. Diluted net loss per share is computed by giving effect to all potential shares of common stock, including convertible senior notes, preferred stock, stock options, RSUs, PSUs and RSAs to the extent dilutive.

The following table sets forth the computation of historical basic and diluted net loss per share for the periods presented (in thousands, except per share data):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2018	2017*	2018	2017*
Numerator:				
Net loss	$(55,705)	$(29,668)	$(277,703)	$(223,385)
Denominator:				
Weighted-average common shares outstanding	147,269	140,482	145,063	139,174
Less: Weighted-average unvested common shares subject to repurchase or forfeiture	(878)	(69)	(48)	(63)
Weighted-average shares used to compute net loss per share, basic and diluted	146,391	140,413	145,015	139,111
Net loss per share, basic and diluted	$(0.38)	$(0.21)	$(1.91)	$(1.61)

* Prior-period information has been adjusted to reflect the adoption of ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which we adopted on February 1, 2018. Refer to Note 1 for further details.

Since we were in a net loss position for all periods presented, basic net loss per share is the same as diluted net loss per share for all periods as the inclusion of all potentially dilutive securities outstanding would have been anti-dilutive. Potentially dilutive securities that were not considered in the diluted per share calculations because they would be anti-dilutive were as follows (in thousands):

	As of October 31,	
	2018	2017
Shares subject to outstanding common stock options	445	1,125
Shares subject to outstanding RSUs, PSUs and RSAs	12,990	11,166
Employee stock purchase plan	398	360
Total	13,833	12,651

As we expect to settle the principal amount of our convertible senior notes in cash, we use the treasury stock method for calculating any potential dilutive effect on diluted net income per share, if applicable. The conversion spread of 14.3 million shares will have a dilutive impact on diluted net income per share of common stock when the average market price of our common stock for a given period exceeds the conversion price of $148.30 per share.

(13) Related Party Transactions

Certain members of our board of directors serve on the board of directors of and/or are executive officers of, and, in some cases, are investors in, companies that are customers or vendors of ours. Certain of our executive officers also serve on the board of directors of companies that are customers or vendors of ours. All contracts with related parties are executed in the ordinary course of business. We recognized revenues from sales to these companies of $3.0 million and $2.7 million for the three months ended October 31, 2018 and 2017, respectively, and $8.1 million and $8.6 million for the nine months ended October 31, 2018 and 2017, respectively. We recorded $0.8 million and $0.6 million in expenses related to purchases from these companies during the three months ended October 31, 2018 and

2017, respectively, and $2.2 million and $1.1 million for the nine months ended October 31, 2018 and 2017, respectively. We had $9.4 million and $2.0 million of current and non-current accounts receivable from these companies as of October 31, 2018 and January 31, 2018, respectively. We had $0.1 million and $0.3 million of accounts payable to these companies as of October 31, 2018 and January 31, 2018, respectively.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes appearing elsewhere in this Quarterly

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Report on Form 10-Q. The following discussion and analysis contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. Statements that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements are often identified by the use of words such as, but not limited to, "anticipate," "believe," "can," "continue," "could," "estimate," "expe "predict," "intend," "may," "might," "plan," "project," "potential," "seek," "should," "target," "will," "would" and similar expr variations intended to identify forward-looking statements. Such statements include, but are not limited to, statements concerning our business and our market opportunity, our future financial and operating results; our planned investments, particularly in our product development efforts; our planned expansion of our sales and marketing organization; our expectation that we will continue to use acquisitions to contribute to our growth objectives; our growth and product integration strategies; our continued efforts to market and sell both domestically and internationally; our expectations about seasonal trends; our ability to achieve our goals; our expectations regarding our revenues mix; our expectations regarding our cost of revenues and gross margin; use of non-GAAP (as defined below) financial measures; our expectations regarding new accounting standards; our expectations regarding our operating expenses, including increases in research and development, sales and marketing, and general and administrative expenses; our expectations regarding our capital expenditures; sufficiency of cash to meet cash needs for at least the next 12 months; exposure to interest rate changes; inflation; anticipated income tax rates and liabilities; our expectations regarding our leases; exposure to exchange rate fluctuations and our ability to manage such exposure; and our expected cash flows and liquidity.

These statements are based on the beliefs and assumptions of our management based on information currently available to us. Such forward-looking statements are subject to risks, uncertainties and other important factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. 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 under Part II, Item 1A below. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances that occur after the date of this report.

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Overview

Splunk provides innovative software solutions that enable organizations to gain real-time operational intelligence by harnessing the value of their data. Our offerings enable users to collect, index, search, explore, monitor, correlate and analyze data regardless of format or source. Our offerings address large and diverse data sets commonly referred to as big data and are specifically tailored for machine data. Machine data is produced by nearly every software application and electronic device across an organization and contains a definitive, time-stamped record of various activities, such as transactions, customer and user behavior, and security threats. Beyond an organization's traditional information technology ("IT") and security infrastructure, data from the Industrial Internet, including industrial control systems, sensors, supervisory control and data acquisition ("SCADA") systems, networks, manufacturing systems, smart meters and the Internet of Things ("IoT"), which includes consumer-oriented systems, such as electronic wearables, mobile devices, automobiles and medical devices is also continuously generating machine data. Our offerings help organizations gain the value contained in machine data by delivering real-time information to enable operational decision making.

We believe the market for products that provide operational intelligence presents a substantial opportunity as data grows in volume and diversity, creating new risks, opportunities and challenges for organizations. Since our inception, we have invested a substantial amount of resources developing our offerings to address this market, specifically with respect to machine data.

Our offerings are designed to deliver rapid return-on-investment for our customers. They generally do not require customization, long deployment cycles or extensive professional services commonly associated with traditional enterprise software applications. Prospective users can get started with our free online sandboxes that enable our customers to immediately try and experience Splunk offerings. Users that prefer to deploy the software on-premises can take advantage of our free 60-day trial of Splunk Enterprise, which converts into a limited free perpetual license of up to 500 megabytes of data per day. Paying users can sign up for Splunk Cloud and avoid the need to provision, deploy and manage internal infrastructure. Alternatively, they can simply download and install the software, typically in a matter of hours, to connect to their relevant machine data sources. Customers can also provision a compute instance on Amazon Web Services via a pre-built Amazon Machine Image, which delivers a pre-configured virtual machine instance with our Splunk Enterprise software. In fiscal 2017, we introduced free development-test licenses for certain commercial customers, allowing users to explore new data and use cases in a non-production environment without incurring additional fees. We also offer support, training and professional services to our customers to assist in the deployment of our software.

For Splunk Enterprise, we base our license fees on the estimated daily data indexing capacity our customers require. A substantial portion of our license revenues consist of revenues from perpetual and term licenses, whereby we generally recognize the license fee portion of these arrangements upfront. As a result, the timing of when we enter into large perpetual and term licenses may lead to fluctuations in our revenues and operating results because our expenses are largely fixed in the short-term. From time to time, we also enter into transactions that are designed to enable broad adoption of our software within an enterprise, referred to as enterprise adoption agreements. These agreements often include provisions that require revenue deferral and recognition over time.

Splunk Cloud delivers the core capabilities of Splunk Enterprise as a scalable, reliable cloud service. Splunk Cloud customers pay an annual subscription fee based on the combination of the volume of data indexed per day and the length of the data retention period. Splunk Light provides log search and analysis that is designed, priced and packaged for small IT environments, where a single-server log analytics solution is sufficient. Splunk Enterprise Security ("ES") addresses emerging security threats and security information and event management ("SIEM") use cases through monitoring, alerts and analytics. Splunk IT Service Intelligence ("ITSI") monitors the health and key performance indicators of critical IT and business services. Splunk User Behavior Analytics ("UBA") detects cyber-attacks and insider threats using data science, machine learning and advanced correlation.

We intend to continue investing for long-term growth. We have invested and intend to continue to invest heavily in product development to deliver additional features and performance enhancements, deployment models and solutions that can address new end markets. For example, we released new versions of existing offerings such as Splunk Enterprise during the three months ended October 31, 2018. We expect to continue to aggressively expand our sales and marketing organizations to market and sell our software both in the United States and internationally. We have utilized and expect to continue to utilize acquisitions to contribute to our long-term growth objectives.

Our goal is to make our software the platform for delivering operational intelligence and real-time business insights from machine data. The key elements of our growth strategy are to:

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- Extend our technological capabilities.
- Continue to expand our direct and indirect sales organization, including our channel relationships, to increase our sales capacity and enable greater market presence.
- Further penetrate our existing customer base and drive enterprise-wide adoption.
- Enhance our value proposition through a focus on solutions which address core and expanded use cases.
- Grow our user communities and partner ecosystem to increase awareness of our brand, target new use cases, drive operational leverage and deliver more targeted, higher value solutions.
- Continue to deliver a rich developer environment to enable rapid development of enterprise applications that leverage machine data and the Splunk platform.

We believe the factors that will influence our ability to achieve our goals include, among other things, our ability to deliver new offerings as well as additional product functionality; acquire new customers across geographies and industries; cultivate incremental sales from our existing customers by driving increased use of our software within organizations; provide additional solutions that leverage our core machine data platform to help organizations understand and realize the value of their machine data in specific end markets and use cases; add additional original equipment manufacturer ("OEM") and strategic relationships to enable new sales channels for our software as well as extend our integration with third-party products; help software developers leverage the functionality of our machine data platform through software development kits ("SDKs") and application programming interfaces ("APIs"); and successfully integrate acquired businesses and technologies.

New Accounting Standard

Prior period information presented in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section and comparative references to prior periods have been adjusted to reflect the impact of the full retrospective adoption of Topic 606. Refer to Note 1 contained in the "Notes to Condensed Consolidated Financial Statements" included in Part I of this Quarterly Report on Form 10-Q for further information.

Financial Summary

For the three months ended October 31, 2018 and 2017, our total revenues were $481.0 million and $342.5 million, respectively. For the three months ended October 31, 2018 and 2017, approximately 24% and 27% of our total revenues, respectively, were derived from customers located outside the United States. Our customers and end-users represent the public sector and a wide variety of industries, including financial services, manufacturing, retail and technology, among others. As of October 31, 2018, we had over 16,000 customers, including over 85 of the Fortune 100 companies.

For the three months ended October 31, 2018 and 2017, our GAAP operating loss was $50.0 million and $29.9 million, respectively. Our non-GAAP operating income was $65.4 million and $53.2 million for the three months ended October 31, 2018 and 2017, respectively.

For the three months ended October 31, 2018 and 2017, our GAAP net loss was $55.7 million and $29.7 million, respectively. Our non-GAAP net income was $57.6 million and $40.4 million for the three months ended October 31, 2018 and 2017, respectively.

Our quarterly results reflect seasonality in the sale of our offerings. Historically, a pattern of increased license sales in the fourth fiscal quarter as a result of industry buying patterns has positively impacted sales activity in that period, which can result in lower sequential revenues in the following first fiscal quarter. Our gross margins and operating losses have been affected by these historical trends because the majority of our expenses are relatively fixed in the short-term. The majority of our expenses are personnel-related and include salaries, stock-based compensation, benefits and incentive-based compensation plan expenses. As a result, we have not experienced significant seasonal fluctuations in the timing of expenses from period to period.

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Non-GAAP Financial Results

To supplement our condensed consolidated financial statements, which are prepared and presented in accordance with GAAP, we provide investors with certain non-GAAP financial measures, including non-GAAP cost of revenues, non-GAAP gross margin, non-GAAP research and development expense, non-GAAP sales and marketing expense, non-GAAP general and administrative expense, non-GAAP operating income (loss), non-GAAP operating margin, non-GAAP income tax provision (benefit), non-GAAP net income (loss) and non-GAAP net income (loss) per share (collectively the "non-GAAP financial measures"). These non-GAAP financial measures exclude all or a combination of the following (as reflected in the following reconciliation tables): expenses related to stock-based compensation and related employer payroll tax, amortization of acquired intangible assets, adjustments related to a financing lease obligation, adjustments related to facility exits, acquisition-related adjustments, including the partial release of the valuation allowance due to acquisitions and non-cash interest expense related to our convertible senior notes. The adjustments for the financing lease obligation are to reflect the expense we would have recorded if our build-to-suit lease arrangement had been deemed an operating lease instead of a financing lease and is calculated as the net of actual ground lease expense, depreciation and interest expense over estimated straight-line rent expense. We issued convertible senior notes in the third quarter of fiscal 2019, and therefore are excluding non-cash interest expense related to our convertible senior notes for the first time in the third quarter of fiscal 2019. The non-GAAP financial measures are also adjusted for our estimated tax rate on non-GAAP income (loss). To determine the annual non-GAAP tax rate, we evaluate a financial projection based on our non-GAAP results. The annual non-GAAP tax rate takes into account other factors including our current operating structure, our existing tax positions in various jurisdictions and key legislation in major jurisdictions where we operate. The non-GAAP tax rate applied to the three and nine months ended October 31, 2018 was 20%. We expect to utilize this annual non-GAAP tax rate in fiscal 2019 and will provide updates to this rate on an annual basis, or more frequently if material changes occur. In addition, non-GAAP financial measures include free cash flow, which represents cash from operations less purchases of property and equipment. The presentation of the non-GAAP financial measures is not intended to be considered in isolation or as a substitute for, or superior to, the financial information prepared and presented in accordance with GAAP. We use these non-GAAP financial measures for financial and operational decision-making purposes and as a means to evaluate period-to-period comparisons. We believe that these non-GAAP financial measures provide useful information about our operating results, enhance the overall understanding of past financial performance and future prospects and allow for greater transparency with respect to key metrics used by management in our financial and operational decision making. In addition, these non-GAAP financial measures facilitate comparisons to competitors' operating results.

We exclude stock-based compensation expense because it is non-cash in nature and excluding this expense provides meaningful supplemental information regarding our operational performance and allows investors the ability to make more meaningful comparisons between our operating results and those of other companies. We exclude employer payroll tax expense related to employee stock plans in order for investors to see the full effect that excluding that stock-based compensation expense had on our operating results. These expenses are tied to the exercise or vesting of underlying equity awards and the price of our common stock at the time of vesting or exercise, which may vary from period to period independent of the operating performance of our business. We also exclude amortization of acquired intangible assets, adjustments related to a financing lease obligation, adjustments related to facility exits, acquisition-related adjustments, including the partial release of the valuation allowance due to our acquisitions, and non-cash interest expense related to our convertible senior notes from our non-GAAP financial measures because these are considered by management to be outside of our core operating results. Accordingly, we believe that excluding these expenses provides investors and management with greater visibility to the underlying performance of our business operations, facilitates comparison of our results with other periods and may also facilitate comparison with the results of other companies in our industry. We consider free cash flow to be a liquidity measure that provides useful information to management and investors about the amount of cash generated by the business that can be used for strategic opportunities, including investing in our business, making strategic acquisitions and strengthening our balance sheet.

There are limitations in using non-GAAP financial measures because the non-GAAP financial measures are not prepared in accordance with GAAP, may be different from non-GAAP financial measures used by our competitors and exclude expenses that may have a material impact upon our reported financial results. Further, stock-based compensation expense has been and will continue to be for the foreseeable future a significant recurring expense in our business and an important part of the compensation provided to our employees. The non-GAAP financial measures are meant to supplement and be viewed in conjunction with GAAP financial measures.

The following table reconciles our net cash provided by operating activities to free cash flow for the three and nine months ended October 31, 2018, and 2017 (in thousands):

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	Three Months Ended		Nine Months Ended	
	October 31, 2018	October 31, 2017	October 31, 2018	October 31, 2017
Net cash provided by operating activities	$59,075	$52,287	$169,086	$116,833
Less purchases of property and equipment	(7,319)	(5,418)	(15,177)	(13,931)
Free cash flow (non-GAAP)	$51,756	$46,869	$153,909	$102,902
Net cash used in investing activities	$(441,746)	$(49,007)	$(700,344)	$(77,175)
Net cash provided by (used in) financing activities	$1,831,647	$(29,538)	$1,855,205	$(68,194)

The following table reconciles our GAAP to Non-GAAP Financial Measures for the three months ended October 31, 2018 (in thousands, except per share amounts):

	GAAP	Stock-based compensation and related employer payroll tax	Amortization of acquired intangible assets	Adjustments related to financing lease obligation	Non-cash interest expense related to convertible senior notes	Income tax effects related to non-GAAP adjustments[3]	Non-GAAP
Cost of revenues	$89,225	$ (9,203)	$ (5,923)	$ 300	$—	$—	$74,399
Gross margin	81.4 %	2.0 %	1.2 %	(0.1)%	— %	— %	84.5 %
Research and development	117,722	(35,892)	(249)	514	—	—	82,095
Sales and marketing	264,223	(46,527)	(955)	1,134	—	—	217,875
General and administrative	59,819	(18,875)	—	259	—	—	41,203
Operating income (loss)	(50,006)	110,497	7,127	(2,207)	—	—	65,411
Operating margin	(10.4)%	23.0 %	1.5 %	(0.5)%	— %	— %	13.6 %
Income tax provision	1,814	—	—	—	—	12,597	14,411
Net income (loss)	$(55,705)	$ 110,497	$ 7,127	$ (169) [2]	$ 8,491	$ (12,597)	$57,644
Net income (loss) per share [1]	$(0.38)						$0.38

[1] GAAP net loss per share calculated based on 146,391 weighted-average shares of common stock. Non-GAAP net income per share calculated based on 152,691 diluted weighted-average shares of common stock, which includes 6,300 potentially dilutive shares related to employee stock awards. GAAP to non-GAAP net income (loss) per share is not reconciled due to the difference in the number of shares used to calculate basic and diluted weighted-average shares of common stock.
[2] Includes $2.0 million of interest expense related to the financing lease obligation.
[3] Represents the tax effect of the non-GAAP adjustments based on the estimated annual effective tax rate of 20%.

The following table reconciles our GAAP to non-GAAP Financial Measures for the three months ended October 31, 2017 (in thousands, except per share amounts):

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	GAAP	Stock-based compensation and related employer payroll tax	Amortization of acquired intangible assets	Adjustments related to financing lease obligation	Adjustments related to facility exits	Acquisition-related adjustments	Income tax effects related to non-GAAP adjustments (4)	Non-GAAP
Cost of revenues	$64,167	$(8,116)	$(2,873)	$316	$—	$—	$—	$53,494
Gross margin	81.3 %	2.4 %	0.8 %	(0.1)%	— %	— %	— %	84.4 %
Research and development	74,080	(25,502)	(130)	489	—	—	—	48,937
Sales and marketing	198,266	(37,789)	(561)	1,170	—	—	—	161,086
General and administrative	35,857	(14,882)	—	230	5,191	(643)	—	25,753
Operating income (loss)	(29,881)	86,289	3,564	(2,205)	(5,191)	643	—	53,219
Operating margin	(8.7)%	25.1 %	1.0 %	(0.6)%	(1.5)%	0.2 %	— %	15.5 %
Income tax provision (benefit)	(232)	—	—	—	—	1,994 (3)	13,166	14,928
Net income (loss)	$(29,668)	$86,289	$3,564	$(111) (2)	$(5,191)	$(1,351)	$(13,166)	$40,366
Net income (loss) per share (1)	$(0.21)							$0.28

(1) GAAP net loss per share calculated based on 140,413 weighted-average shares of common stock. Non-GAAP net income per share calculated based on 144,415 diluted weighted-average shares of common stock, which includes 4,002 potentially dilutive shares related to employee stock awards. GAAP to non-GAAP net income (loss) per share is not reconciled due to the difference in the number of shares used to calculate basic and diluted weighted-average shares of common stock.
(2) Includes $2.1 million of interest expense related to the financing lease obligation.
(3) Represents the partial release of the valuation allowance.
(4) Represents the tax effect of the non-GAAP adjustments based on the estimated annual effective tax rate of 27%.

The following table reconciles our GAAP to Non-GAAP Financial Measures for the nine months ended October 31, 2018 (in thousands, except per share amounts):

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	GAAP	Stock-based compensation and related employer payroll tax	Amortization of acquired intangible assets	Adjustments related to financing lease obligation	Acquisition-related adjustments	Non-cash interest expense related to convertible senior notes	Income tax effects related to non-GAAP adjustments[4]	Non-GAAP
Cost of revenues	$250,943	$(28,190)	$(15,526)	$916	$—	$—	$—	$208,143
Gross margin	78.8%	2.4%	1.3%	(0.1)%	—%	—%	—%	82.4%
Research and development	310,818	(98,648)	(795)	1,510	—	—	—	212,885
Sales and marketing	726,089	(139,387)	(1,785)	3,451	—	—	—	588,368
General and administrative	168,405	(53,602)	—	741	(6,034)	—	—	109,510
Operating income (loss)	(275,330)	319,827	18,106	(6,618)	6,034	—	—	62,019
Operating margin	(23.3)%	27.2%	1.5%	(0.6)%	0.5%	—%	—%	5.3%
Income tax provision	637	—	—	—	3,313 [3]	—	11,037	14,987
Net income (loss)	$(277,703)	$319,827	$18,106	$(456) [2]	$2,721	$8,491	$(11,037)	$59,949
Net income (loss) per share [1]	$(1.91)							$0.40

[1] GAAP net loss per share calculated based on 145,015 weighted-average shares of common stock. Non-GAAP net income per share calculated based on 151,451 diluted weighted-average shares of common stock, which includes 6,436 potentially dilutive shares related to employee stock awards. GAAP to non-GAAP net income (loss) per share is not reconciled due to the difference in the number of shares used to calculate basic and diluted weighted-average shares of common stock.
[2] Includes $6.2 million of interest expense related to the financing lease obligation.
[3] Represents the partial release of the valuation allowance.
[4] Represents the tax effect of the non-GAAP adjustments based on the estimated annual effective tax rate of 20%.

The following table reconciles our GAAP to non-GAAP Financial Measures for the nine months ended October 31, 2017 (in thousands, except per share amounts):

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	GAAP	Stock-based compensation and related employer payroll tax	Amortization of acquired intangible assets	Adjustments related to financing lease obligation	Adjustments related to facility exits	Acquisition-related adjustments	Income tax effects related to non-GAAP adjustments [4]	Non-GAAP
Cost of revenues	$182,206	$(25,436)	$(8,392)	$931	$—	$—	$—	$149,309
Gross margin	78.6 %	2.9 %	1.0 %	(0.1)%	— %	— %	— %	82.4 %
Research and development	217,152	(80,100)	(213)	1,515	—	—	—	138,354
Sales and marketing	558,364	(124,041)	(1,893)	3,514	—	—	—	435,944
General and administrative	111,492	(45,673)	—	694	5,191	(643)	—	71,061
Operating income (loss)	(219,733)	275,250	10,498	(6,654)	(5,191)	643	—	54,813
Operating margin	(25.9)%	32.5 %	1.2 %	(0.8)%	(0.6)%	0.1 %	— %	6.5 %
Income tax provision	1,459	—	—	—	—	2,540 [3]	11,913	15,912
Net income (loss)	$(223,385)	$275,250	$10,498	$(339) [2]	$(5,191)	$(1,897)	$(11,913)	$43,023
Net income (loss) per share [1]	$(1.61)							$0.30

[1] GAAP net loss per share calculated based on 139,111 weighted-average shares of common stock. Non-GAAP net income per share calculated based on 143,552 diluted weighted-average shares of common stock, which includes 4,441 potentially dilutive shares related to employee stock awards. GAAP to non-GAAP net income (loss) per share is not reconciled due to the difference in the number of shares used to calculate basic and diluted weighted-average shares of common stock.
[2] Includes $6.3 million of interest expense related to the financing lease obligation.
[3] Represents the partial release of the valuation allowance.
[4] Represents the tax effect of the non-GAAP adjustments based on the estimated annual effective tax rate of 27%.

Components of Operating Results

Revenues

License revenues. License revenues reflect the revenues recognized from sales of licenses to new customers and additional licenses to existing customers, including sales from the renewal of term licenses. We are focused on acquiring new customers and increasing revenues from our existing customers as they realize the value of our software by indexing higher volumes of machine data and expanding the use of our software through additional use cases and broader deployment within their organizations. Our license revenues consist of revenues from perpetual licenses and term licenses, under which we generally recognize the license fee portion of the arrangement upfront, assuming all revenue recognition criteria are satisfied. In addition, seasonal trends that contribute to increased sales activity in the fourth fiscal quarter often result in lower sequential revenues in the first fiscal quarter, and we expect this trend to continue. Comparing our revenues on a period-to-period basis may not be meaningful, and our past results should not be relied upon as an indication of our future performance. Our historical methods of revenue recognition are materially affected by the adoption of a new revenue recognition standard. Refer to Note 1 contained in the "Notes to Condensed Consolidated Financial Statements" included in Part I of this Quarterly Report on Form 10-Q for further information.

Maintenance and services revenues. Maintenance and services revenues consist of revenues from maintenance agreements, cloud services and professional services and training.

- Maintenance revenues. Typically, when purchasing a perpetual license, a customer also purchases one year of maintenance for which we charge a percentage of the license fee. When a term license is purchased, maintenance is typically bundled with the license for the term of the license period. Customers with maintenance agreements are

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entitled to receive support and unspecified upgrades and enhancements when and if they become available during the maintenance period. We recognize the revenues associated with maintenance agreements ratably, on a straight-line basis, over the associated maintenance period.

- Cloud services revenues. Cloud services allow customers to use hosted software over the contract period without taking possession of the software. We generally recognize the revenues associated with our cloud services ratably, on a straight-line basis, over the associated subscription term.

- Professional services and training services. We have a professional services organization focused on helping our customers deploy our software in highly complex operational environments and train their personnel. Training and professional services have stated billing rates per service hour or are provided on a subscription basis, accordingly, revenues are recognized as services are delivered or ratably over the subscription period. Professional services and training revenues, as a percentage of total revenues, were 8% and 9% for the three months ended October 31, 2018 and 2017, respectively. We have experienced continued growth in our professional services revenues primarily due to the deployment of our software with some customers that have large, highly complex IT environments.

Cost of Revenues

Cost of license revenues. Cost of license revenues includes all direct costs to deliver our products, including salaries, benefits, stock-based compensation and related expenses such as employer taxes, allocated overhead for facilities and IT and amortization of acquired intangible assets. We recognize these expenses as they are incurred.

Cost of maintenance and services revenues. Cost of maintenance and services revenues includes salaries, benefits, stock-based compensation and related expenses such as employer taxes for our maintenance and services organization, allocated overhead for depreciation of equipment, facilities and IT, amortization of acquired intangible assets and third-party hosting fees related to our cloud services. We recognize expenses related to our maintenance and services organization as they are incurred.

Operating Expenses

Our operating expenses are classified into three categories: research and development, sales and marketing and general and administrative. For each category, the largest component is personnel costs, which include salaries, employee benefit costs, bonuses, commissions as applicable, stock-based compensation and related expenses such as employer taxes. Operating expenses also include allocated overhead costs for depreciation of equipment, facilities and IT. Allocated costs for facilities include costs for compensation of our facilities personnel, leasehold improvements and rent. Our allocated costs for IT include costs for compensation of our IT personnel and costs associated with our IT infrastructure. Operating expenses are generally recognized as incurred.

Research and development. Research and development expenses primarily consist of personnel and facility-related costs attributable to our research and development personnel. We have devoted our product development efforts primarily to enhancing the functionality and expanding the capabilities of our software and services. We expect that our research and development expenses will continue to increase, in absolute dollars, as we increase our research and development headcount to further strengthen and enhance our software and services and invest in the development of our solutions and apps.

Sales and marketing. Sales and marketing expenses primarily consist of personnel and facility-related costs for our sales, marketing and business development personnel, commissions earned by our sales personnel, and the cost of marketing and business development programs. We expect that sales and marketing expenses will continue to increase, in absolute dollars, as we continue to hire additional personnel and invest in marketing programs.

General and administrative. General and administrative expenses primarily consist of personnel and facility-related costs for our executive, finance, legal, human resources and administrative personnel; our legal, accounting and other professional services fees; and other corporate expenses. We anticipate continuing to incur additional expenses due to growing our operations, including higher legal, corporate insurance and accounting expenses.

Interest and Other Income (Expense), Net

Interest and other income (expense), net consists primarily of interest expense related to our convertible senior notes, foreign exchange gains and losses, interest income on our investments and cash and cash equivalents balances, and changes in the fair value of forward exchange contracts.

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Income Tax Provision (Benefit)

The income tax provision (benefit) consists of federal, state and foreign income taxes. We recognize deferred tax assets and liabilities for the expected tax consequences of temporary differences between the tax basis of assets and liabilities and their reported amounts using enacted tax rates in effect for the year in which we expect the differences to reverse. We record a valuation allowance to reduce the deferred tax assets to the amount that we are more-likely-than-not to realize. Because of our history of U.S. net operating losses, we have established, in prior years, a full valuation allowance against potential future benefits for U.S. deferred tax assets including loss carry-forwards and research and development and other tax credits. We regularly assess the likelihood that our deferred income tax assets will be realized based on the realization guidance available. To the extent that we believe any amounts are not more-likely-than-not to be realized, we record a valuation allowance to reduce the deferred income tax assets. We regularly assess the need for the valuation allowance on our deferred tax assets, and to the extent that we determine that an adjustment is needed, such adjustment will be recorded in the period that the determination is made.

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Results of Operations

The following tables set forth our results of operations for the periods presented and as a percentage of our total revenues for those periods. The period-to-period comparison of financial results is not necessarily indicative of financial results to be achieved in future periods.

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2018	2017	2018	2017
	(in thousands)			
Condensed Consolidated Statements of Operations Data:				
Revenues				
License	$279,603	$193,810	$619,246	$443,603
Maintenance and services	201,380	148,679	561,679	405,878
Total revenues	480,983	342,489	1,180,925	849,481
Cost of revenues				
License	5,922	3,013	16,717	9,100
Maintenance and services	83,303	61,154	234,226	173,106
Total cost of revenues	89,225	64,167	250,943	182,206
Gross profit	391,758	278,322	929,982	667,275
Operating expenses				
Research and development	117,722	74,080	310,818	217,152
Sales and marketing	264,223	198,266	726,089	558,364
General and administrative	59,819	35,857	168,405	111,492
Total operating expenses	441,764	308,203	1,205,312	887,008
Operating loss	(50,006)	(29,881)	(275,330)	(219,733)
Interest and other income (expense), net				
Interest income	8,571	2,403	15,322	6,273
Interest expense	(12,270)	(2,133)	(16,401)	(6,695)
Other income (expense), net	(186)	(289)	(657)	(1,771)
Total interest and other income (expense), net	(3,885)	(19)	(1,736)	(2,193)
Loss before income taxes	(53,891)	(29,900)	(277,066)	(221,926)
Income tax provision (benefit)	1,814	(232)	637	1,459
Net loss	$(55,705)	$(29,668)	$(277,703)	$(223,385)

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	Three Months Ended October 31,		Nine Months Ended October 31,	
	2018	2017	2018	2017
	(as % of revenues)			
Condensed Consolidated Statements of Operations Data:				
Revenues				
License	58.1 %	56.6 %	52.4 %	52.2 %
Maintenance and services	41.9	43.4	47.6	47.8
Total revenues	100.0	100.0	100.0	100.0
Cost of revenues				
License [(1)]	2.1	1.6	2.7	2.1
Maintenance and services [(1)]	41.4	41.1	41.7	42.6
Total cost of revenues	18.6	18.7	21.2	21.4
Gross profit	81.4	81.3	78.8	78.6
Operating expenses				
Research and development	24.5	21.6	26.3	25.6
Sales and marketing	54.9	57.9	61.5	65.8
General and administrative	12.4	10.5	14.3	13.1
Total operating expenses	91.8	90.0	102.1	104.5
Operating loss	(10.4)	(8.7)	(23.3)	(25.9)
Interest and other income (expense), net				
Interest income	1.8	0.6	1.4	0.8
Interest expense	(2.6)	(0.6)	(1.4)	(0.8)
Other income (expense), net	—	(0.1)	(0.1)	(0.2)
Total interest and other income (expense), net	(0.8)	(0.1)	(0.1)	(0.2)
Loss before income taxes	(11.2)	(8.8)	(23.4)	(26.1)
Income tax provision (benefit)	0.4	(0.1)	0.1	0.2
Net loss	(11.6)%	(8.7)%	(23.5)%	(26.3)%

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(1) Calculated as a percentage of the associated revenues.

Comparison of the Three Months Ended October 31, 2018 and 2017

Revenues

	Three Months Ended October 31,		
	2018	2017	% Change
	($ amounts in thousands)		
Revenues			
License	$279,603	$193,810	44.3 %
Maintenance and services	201,380	148,679	35.4 %
Total revenues	$480,983	$342,489	40.4 %
Percentage of revenues			
License	58.1 %	56.6 %	
Maintenance and services	41.9	43.4	
Total	100.0 %	100.0 %	

The increase in license revenues of $85.8 million was primarily driven by increases in our total number of customers, sales to existing customers and the number of large orders. For example, we had 111 and 69 orders greater than $1.0 million for the three months ended October 31, 2018 and 2017, respectively. Our total number of customers increased from approximately 14,000 as of October 31, 2017 to more than 16,000 as of October 31, 2018. The increase in maintenance and services revenues

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of $52.7 million was due to increases in sales of maintenance agreements, increases in sales of our cloud services, as well as sales of professional services resulting from the growth of our installed customer base.

Cost of Revenues and Gross Margin

	Three Months Ended October 31, 2018	2017	% Change
	($ amounts in thousands)		
Cost of revenues [(1)]			
License	$ 5,922	$ 3,013	96.5 %
Maintenance and services	83,303	61,154	36.2 %
Total cost of revenues	$ 89,225	$ 64,167	39.1 %
Gross margin			
License	97.9 %	98.4 %	
Maintenance and services	58.6 %	58.9 %	
Total gross margin	81.4 %	81.3 %	
[(1)] Includes stock-based compensation expense:			
Cost of revenues	$ 8,867	$ 7,921	

Total cost of revenues increased $25.1 million primarily due to a $22.1 million increase in cost of maintenance and services revenues. The increase in cost of maintenance and services revenues was primarily related to a $10.1 million increase in salaries and benefits expense due to increased headcount, an increase of $7.3 million related to third-party hosting fees to support our cloud services and a $4.1 million increase in expenses related to third-party consulting services. The $2.9 million increase in cost of license revenues was primarily due to amortization expense related to acquired intangible assets. Total gross margin remained relatively flat.

Operating Expenses

	Three Months Ended October 31, 2018	2017	% Change
	($ amounts in thousands)		
Operating expenses [(1)]			
Research and development	$ 117,722	$ 74,080	58.9 %
Sales and marketing	264,223	198,266	33.3 %
General and administrative	59,819	35,857	66.8 %
Total operating expenses	$ 441,764	$ 308,203	43.3 %
Percentage of revenues			
Research and development	24.5 %	21.6 %	
Sales and marketing	54.9	57.9	
General and administrative	12.4	10.5	
Total	91.8 %	90.0 %	
[(1)] Includes stock-based compensation expense:			
Research and development	$ 35,088	$ 25,038	
Sales and marketing	45,280	36,728	
General and administrative	18,449	14,424	

Total stock-based compensation expense	$98,817	$76,190

Research and development expense. Research and development expense increased $43.6 million primarily due to an increase of $33.5 million in salaries and benefits as we increased headcount and an increase of $4.0 million in hosting fees to support our product development efforts.

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Sales and marketing expense. Sales and marketing expense increased $66.0 million primarily due to a $53.9 million increase in salaries and benefits as we increased headcount and experienced higher commission expense as a result of increased customer orders. We also experienced an increase of $3.3 million in marketing expenses, an increase of $3.0 million in travel-related expenses due to increased travel from our growing field sales organization and an increase of $1.9 million in third-party consulting services.

General and administrative expense. General and administrative expense increased $24.0 million primarily due to an increase of $12.9 million in salaries and benefits as we increased headcount, an increase of $6.1 million in rent expense and an increase of $3.1 million in third-party consulting services. The increase in rent expense was primarily due to a decrease of $5.2 million of expense in connection with a facility exit charge adjustment that occurred during the three months ended October 31, 2017.

Interest and Other Income (Expense), net

	Three Months Ended October 31,	
	2018	2017
	(in thousands)	
Interest and other income (expense), net		
Interest income	$8,571	$2,403
Interest expense	(12,270)	(2,133)
Other income (expense), net	(186)	(289)
Total interest and other income (expense), net	$(3,885)	$(19)

Interest and other income (expense), net reflects a net increase in expense primarily due to an increase in interest expense related to the issuance of our convertible senior notes, partially offset by interest earned from our investments.

Income Tax Provision (Benefit)

	Three Months Ended October 31,	
	2018	2017
	(in thousands)	
Income tax provision (benefit)	$1,814	$(232)

The increase in income tax expense for the three months ended October 31, 2018 was primarily due to the partial release of the valuation allowance as a result of an acquisition during the three months ended October 31, 2017.

Comparison of the Nine Months Ended October 31, 2018 and 2017

Revenues

Nine Months Ended October 31,		
2018	2017	% Change

	($ amounts in thousands)					
Revenues						
License	$619,246		$443,603		39.6	%
Maintenance and services	561,679		405,878		38.4	%
Total revenues	$1,180,925		$849,481		39.0	%
Percentage of revenues						
License	52.4	%	52.2	%		
Maintenance and services	47.6		47.8			
Total	100.0	%	100.0	%		

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The increase in license revenues of $175.6 million was primarily driven by increases in our total number of customers, sales to existing customers and an increase in the number of large orders. For example, we had 215 and 154 orders greater than $1.0 million for the nine months ended October 31, 2018 and 2017, respectively. Our total number of customers increased from approximately 14,000 as of October 31, 2017 to more than 16,000 as of October 31, 2018. The increase in maintenance and services revenues of $155.8 million was due to increases in sales of maintenance agreements, increases in sales of our cloud services, as well as sales of professional services resulting from the growth of our installed customer base.

Cost of Revenues and Gross Margin

	Nine Months Ended October 31, 2018	2017	% Change
	($ amounts in thousands)		
Cost of revenues			
License	$16,717	$9,100	83.7 %
Maintenance and services	234,226	173,106	35.3 %
Total cost of revenues	$250,943	$182,206	37.7 %
Gross margin			
License	97.3 %	97.9 %	
Maintenance and services	58.3 %	57.4 %	
Total gross margin	78.8 %	78.6 %	

(1) Includes stock-based compensation expense:

Cost of revenues	$26,618	$24,523

Total cost of revenues increased $68.7 million primarily due to a $61.1 million increase in cost of maintenance and services revenues. The $61.1 million increase in cost of maintenance and services revenues was primarily related to an increase of $27.8 million in salaries and benefits expense, an increase of $15.9 million related to third-party hosting fees to support our cloud services and an increase of $15.6 million related to third-party consulting services. The $7.6 million increase in cost of license revenues was primarily due to amortization expense related to acquired intangible assets. Total gross margin remained relatively flat.

Operating Expenses

	Nine Months Ended October 31, 2018	2017	% Change
	($ amounts in thousands)		
Operating expenses (1)			
Research and development	$310,818	$217,152	43.1 %
Sales and marketing	726,089	558,364	30.0 %
General and administrative	168,405	111,492	51.0 %
Total operating expenses	$1,205,312	$887,008	35.9 %
Percentage of revenues			
Research and development	26.3 %	25.6 %	
Sales and marketing	61.5	65.8	
General and administrative	14.3	13.1	
Total	102.1 %	104.5 %	

(1) Includes stock-based compensation expense:

Research and development	$95,101	$77,826
Sales and marketing	133,874	120,023
General and administrative	51,756	44,161
Total stock-based compensation expense	$280,731	$242,010

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Research and development expense. Research and development expense increased $93.7 million primarily due to a net $67.8 million increase in salaries and benefits. We also had an increase of $10.7 million in hosting fees to support our product development efforts and a $3.4 million increase related to third-party consulting services.

Sales and marketing expense. Sales and marketing expense increased $167.7 million primarily due to a $129.5 million increase in salaries and benefits, as we increased headcount and experienced higher commission expense as a result of increased customer orders. Additionally, we experienced an increase of $12.0 million in travel-related expenses due to increased travel from our growing field sales organization, an $8.0 million increase in marketing expenses, a $6.0 million increase in third-party consulting services and an increase of $4.2 million related to our sales kickoff and other sales-related events.

General and administrative expense. General and administrative expense increased $56.9 million primarily due to a $27.0 million increase in salaries and benefits as we increased headcount, an increase of $13.3 million in third-party consulting services, an increase of $9.5 million in rent expense and an increase of $3.8 million in accounting and legal expenses. The increase in rent expense was partially due to a decrease of $5.2 million of expense in connection with a facility exit charge adjustment that occurred during the nine months ended October 31, 2017.

Interest and Other Income (Expense), net

	Nine Months Ended October 31, 2018	2017
	(in thousands)	
Interest and other income (expense), net		
Interest income	$15,322	$6,273
Interest expense	(16,401)	(6,695)
Other income (expense), net	(657)	(1,771)
Total interest and other income (expense), net	$(1,736)	$(2,193)

Interest and other income (expense), net reflects a net decrease in expense primarily due to an increase in interest income from our investments and a decrease in foreign exchange losses, partially offset by an increase in interest expense related to the issuance of our convertible senior notes.

Income Tax Provision

	Nine Months Ended October 31, 2018	2017
	(in thousands)	
Income tax provision	$637	$1,459

The decrease in income tax expense for the nine months ended October 31, 2018 was primarily due to an increase in excess tax benefits partially offset by an increase in foreign taxes.

Liquidity and Capital Resources

	October 31, 2018	January 31, 2018

	(in thousands)	
Cash and cash equivalents	$1,868,116	$545,947

	Nine Months Ended October 31,	
	2018	2017
	(in thousands)	
Cash provided by operating activities	$169,086	$116,833
Net cash used in investing activities	(700,344)	(77,175)
Net cash provided by (used in) financing activities	1,855,205	(68,194)

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As of October 31, 2018, we had $1.87 billion of cash, cash equivalents and short-term and long-term marketable securities. We intend to continue to focus our capital expenditures for the remainder of fiscal 2019 to support the growth in our operations, including acquisition-related activities.

In September 2018, we issued $2.13 billion aggregate principal amount of convertible senior notes, which includes $1.27 billion aggregate principal amount of 0.50% Convertible Senior Notes due 2023 and $862.5 million aggregate principal amount of 1.125% Convertible Senior Notes due 2025 (collectively, the “Notes”). In connection with the issuance of the Notes, we entered into privately negotiated capped call transactions with certain counterparties (the “Capped Calls”). The premiums paid for the purchase of the Capped Calls were $274.3 million.

Our future capital requirements will depend on many factors including our growth rate, the timing and extent of spending to support development efforts, the expansion of sales and marketing activities, the introduction of new and enhanced software and services offerings, the continuing market acceptance of our offerings and our planned investments, particularly in our product development efforts or acquisitions of complementary businesses, applications or technologies.

In the event that additional financing is required from outside sources, we may not be able to raise it on terms acceptable to us, if at all. If we are unable to raise additional capital when desired, our business, operating results and financial condition could be adversely affected.

Operating Activities

Operating activities consist of our net loss adjusted for certain non-cash items and changes in operating assets and liabilities during the year.

Net cash provided by operating activities was $169.1 million for the nine months ended October 31, 2018 compared to $116.8 million from the prior year. The increase in net cash provided by operating activities was primarily related to an increase in accounts receivable collections during the nine months ended October 31, 2018 as compared to the prior year. This increase was partially offset by an increase in payments for prepaid expenses, a decrease in deferred revenue and an increase in payments for deferred commissions as compared to the prior year.

Net cash provided by operating activities was $116.8 million for the nine months ended October 31, 2017 compared to $99.3 million from the prior year. The increase in net cash provided by operating activities was primarily related to a reduction in payments for accrued compensation and an increase in deferred revenue during the nine months ended October 31, 2017 as compared to the prior year. This increase was partially offset by a reduction in accounts receivable collections as compared to the prior year.

Investing Activities

Net cash used in investing activities was $700.3 million for the nine months ended October 31, 2018 compared to $77.2 million from the prior year. The increase in cash used in investing activities was primarily related to a $335.6 million increase in cash purchase price paid, net of cash acquired, from our acquisitions of Phantom and VictorOps and an increase of $281.2 million in purchases of investments, net of maturities, as compared to the prior year.

Net cash used in investing activities was $77.2 million for the nine months ended October 31, 2017 compared to $108.2 million from the prior year. The decrease in cash used by investing activities was primarily related to an increase of $67.7 million in maturities of investments and a decrease of $13.3 million in purchases of property and equipment as compared to the prior year. This inflow was partially offset by an increase of $59.4 in cash purchase price paid, net of cash acquired, for acquisitions.

Financing Activities

Net cash provided by financing activities was $1.86 billion for the nine months ended October 31, 2018 compared to net cash used in financing activities of $68.2 million from the prior year. The increase in cash provided by financing activities was related to the issuance of $2.1 billion in convertible senior notes, net of initial purchaser discounts and issuance costs. This increase was partially offset by $274.3 million in cash used to purchase capped calls in connection with the issuance of our convertible senior notes. We also experienced a decrease of $87.9 million in taxes paid related to net share settlement of equity awards as compared to the prior year.

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Net cash used in financing activities was $68.2 million for the nine months ended October 31, 2017 compared to $50.3 million from the prior year. The increase in cash used in financing activities was primarily related to an increase of $15.3 million in taxes paid related to net share settlement of equity awards.

Loan Agreement

On May 9, 2013, we entered into a Loan Agreement with Silicon Valley Bank, which provided us with a revolving line of credit facility. Under the agreement, we could borrow up to $25 million with interest accrued either at the prime rate or the LIBOR rate plus 2.75%. We never borrowed under the credit facility, and during the three months ended October 31, 2018, we terminated our Loan Agreement with Silicon Valley Bank.

Operating Lease Commitments and Contractual Obligations

We lease our office spaces under non-cancelable leases. Rent expense, net of sublease income, for our operating leases was $6.3 million and $0.3 million for the three months ended October 31, 2018 and 2017, respectively. During the three months ended October 31, 2017, rent expense included a decrease of $5.2 million of expense in connection with a facility exit charge adjustment. Rent expense, net of sublease income, for our operating leases was $18.5 million and $10.8 million for the nine months ended October 31, 2018 and 2017, respectively.

On August 15, 2018, we entered into an office lease at 3060 Olsen Drive for approximately 301,000 square feet located in San Jose, California. This lease is expected to commence in fiscal 2020 for a term of 130 months, subject to the completion of certain pre-occupancy improvements by our landlord. Our total obligation for the base rent will be approximately $162.6 million.

On June 18, 2018, we renewed our office lease at 250 Brannan Street for approximately 101,000 square feet located in San Francisco, California. This lease is expected to commence in the first quarter of fiscal 2020 for a term of 147 months. Our total obligation for the base rent will be approximately $137.6 million.

Purchase obligations are contractual obligations for purchase of goods or services and are defined as agreements that are enforceable and legally binding and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum, or variable price provisions; and the approximate timing of the transaction.

The following summarizes our convertible senior notes, operating lease commitments and significant purchase obligations as of October 31, 2018 (in thousands):

	Payments Due by Period				
	Total	Less Than 1 year	1-3 years	3-5 years	More Than 5 years
0.5% Convertible Senior Notes due 2023	$1,270,000	$ —	$—	$1,270,000	$—
1.125% Convertible Senior Notes due 2025	862,500	—	—	—	862,500
Operating lease commitments [1]	469,227	26,611	93,566	86,296	262,754
Purchase obligations [2]	65,099	18,914	36,880	6,383	2,922
Total	$2,666,826	$ 45,525	$130,446	$1,362,679	$ 1,128,176

(1) We have entered into sublease agreements for portions of our office space and the future rental income of $1.9 million from these agreements has been included as an offset to our future minimum rental payments.
(2) Purchase obligations relate primarily to IT and product infrastructure costs, enterprise subscription agreements, and sales and marketing costs.

Financing Lease Obligation

On April 29, 2014, we entered into an office lease (the “Lease”) for approximately 182,000 square feet located at 270 Brannan Street, San Francisco, California (the “Premises”). The Premises is allocated between the “Initial Premises” and “Additional Premises,” which are each approximately 91,000 square feet of rentable space. The term of the Additional Premises begins one year after the term of the Initial Premises, which began in August 2015, and each have a term of 84 months. Our total obligation for the base rent is approximately $92.0 million. On May 13, 2014, we entered into an irrevocable, standby letter of credit with Silicon Valley Bank for $6.0 million to serve as a security deposit for the Lease.

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As a result of our involvement during the construction period, whereby we had certain indemnification obligations related to the construction, we were considered, for accounting purposes only, the owner of the construction project under build-to-suit lease accounting. We have recorded project construction costs incurred by the landlord as an asset and a corresponding long-term liability in “Property and equipment, net” and “Other liabilities, non-current,” respectively, on our condensed consolidated balance sheets. We moved into the Premises in February 2016. We have determined that the Lease does not meet the criteria for “sale-leaseback” treatment, due to our continuing involvement in the construction project resulting from our standby letter of credit. Accordingly, the Lease will continue to be accounted for as a financing obligation.

As of October 31, 2018, future payments on the financing lease obligation are as follows (in thousands):

Fiscal Period:	
Remaining three months of fiscal 2019	$3,144
Fiscal 2020	12,928
Fiscal 2021	13,316
Fiscal 2022	13,715
Fiscal 2023	14,127
Thereafter	8,142
Total future minimum lease payments	$65,372

Capital Commitment

We have made a $5.0 million capital commitment to a venture capital fund that requires us to contribute capital upon notice. As of October 31, 2018, we have contributed $0.8 million towards our capital commitment.

Off-Balance Sheet Arrangements

During the nine months ended October 31, 2018 and 2017, we did not have any relationships with unconsolidated organizations or financial partnerships, such as structured finance or special purpose entities that have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Indemnification Arrangements

During the ordinary course of business, we may indemnify, hold harmless and agree to reimburse for losses suffered or incurred, our customers, vendors and their affiliates for certain intellectual property infringement and other claims by third parties with respect to our offerings, in connection with our commercial end-user license arrangements or related to general business dealings with those parties.

As permitted under Delaware law, we have entered into indemnification agreements with our officers, directors and certain employees, indemnifying them for certain events or occurrences while they serve as our officers or directors or those of our direct and indirect subsidiaries.

To date, there have not been any costs incurred in connection with such indemnification obligations; therefore, there is no accrual of such amounts as of October 31, 2018. We are unable to estimate the maximum potential impact of these indemnifications on our future results of operations.

Critical Accounting Policies and Estimates

We prepare our condensed consolidated financial statements in accordance with GAAP. The preparation of condensed consolidated financial statements also requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, costs and expenses and related disclosures. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results could differ significantly from the estimates made by our management. To the extent that there are differences between our estimates and actual results, our future financial statement presentation, financial condition, results of operations and cash flows will be affected.

We adopted Topic 606 on February 1, 2018 using the full retrospective method. Refer to Note 1 contained in the "Notes to Condensed Consolidated Financial Statements" included in Part I of this Quarterly Report on Form 10-Q for further information. Other than the adoption of Topic 606, there have been no material changes to our critical accounting policies and

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estimates as compared to the critical accounting policies and estimates described in our Annual Report on Form 10-K for the fiscal year ended January 31, 2018, filed with the SEC on March 30, 2018.

Recently Issued Accounting Pronouncements

For information with respect to recent accounting pronouncements and the impact of these pronouncements on our condensed consolidated financial statements, see Note 1 contained in the "Notes to Condensed Consolidated Financial Statements" included in Part I of this Quarterly Report on Form 10-Q.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

We had cash and cash equivalents of $1.87 billion as of October 31, 2018. We hold our cash and cash equivalents for working capital purposes. Our cash and cash equivalents are held in cash deposits and money market funds. The primary objective of our investment activities is to preserve principal while maximizing yields without significantly increasing risk. This objective is accomplished by making diversified investments, consisting only of investment grade securities. The effect of a hypothetical 10% increase or decrease in overall interest rates would not have had a material impact on our interest income.

In September 2018, we issued $2.1 billion aggregate principal amount of convertible senior notes in a private placement, which includes $1.27 billion aggregate principal amount of 0.50% Convertible Senior Notes due 2023 and $862.5 million aggregate principal amount of 1.125% Convertible Senior Notes due 2025 (together, the "Notes"). As these instruments have a fixed annual interest rate, we have no financial or economic interest exposure associated with changes in interest rates. However, the fair value of fixed rate debt instruments fluctuates when interest rates change. Additionally, the fair value of either series of Notes can be affected when the market price of our common stock fluctuates. We carry the Notes at face value less unamortized discount on our balance sheet, and we present the fair value for required disclosure purposes only.

Foreign Currency Exchange Risk

Our results of operations and cash flows are subject to fluctuations due to changes in foreign currency exchange rates. All of our revenues are generated in U.S. dollars. Our expenses are generally denominated in the currencies in which our operations are located, which is primarily in the United States and to a lesser extent in Europe and Asia. Our results of operations and cash flows are, therefore, subject to fluctuations due to changes in foreign currency exchange rates and may be adversely affected in the future due to changes in foreign exchange rates. We seek to minimize the impact of certain foreign currency fluctuations by hedging certain balance sheet exposures with foreign currency forward contracts. Any gain or loss from settling these contracts is offset by the loss or gain derived from the underlying balance sheet exposures. We do not enter into any hedging contracts for trading or speculative purposes. The effect of a hypothetical 10% change in foreign currency exchange rates applicable to our business would not have a material impact on our historical consolidated financial statements. As our international operations grow, we will continue to reassess our approach to manage our risk relating to fluctuations in currency rates.

Inflation

We do not believe that inflation had a material effect on our business, financial condition or results of operations in the nine months ended October 31, 2018 and 2017. If our costs were to become subject to significant inflationary pressures, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could harm our business, financial condition and results of operations.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of October 31, 2018. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Based on the evaluation of our disclosure controls and procedures as of October 31, 2018, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

Our management, including our Chief Executive Officer and Chief Financial Officer, believes that our disclosure controls and procedures and internal control over financial reporting are designed to provide reasonable assurance of achieving their objectives and are effective at the reasonable assurance level. However, our management does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all errors and all fraud. A control system, 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 their 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, have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The information set forth above under Legal Proceedings in Note 3 contained in the "Notes to Condensed Consolidated Financial Statements" is incorporated herein by reference.

Item 1A. Risk Factors

Our operations and financial results are subject to various risks and uncertainties including those described below. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties that we are unaware of, or that we currently believe are not material, also may become important factors that affect us. If any of the following risks or others not specified below materialize, our business, financial condition and results of operations could be materially adversely affected. In that case, the trading price of our common stock could decline.

Our future operating results may fluctuate significantly, we are transitioning our business model, and our recent operating results may not be a good indication of our future performance.

Our revenues, operating margins, cash flows and other operating results could vary significantly from period to period as a result of various factors, many of which are outside of our control. For example, we have historically generated a majority of our revenues from perpetual license agreements, whereby we generally recognize the license fee portion of the arrangement upfront, assuming all revenue recognition criteria are satisfied. Our customers also have the choice of entering into agreements for term licenses and agreements for our cloud services. We are currently transitioning our business model to shift from sales of perpetual licenses in favor of sales of term licenses and subscription agreements for our cloud services. This transition may give rise to a number of risks, and if we do not successfully execute this transition, our business and future operating results could be adversely affected.

Under accounting standards update No. 2014-09 (Topic 606), Revenue from Contracts with Customers, which we adopted as of February 1, 2018, we recognize term license revenues, in addition to perpetual license revenues, upfront and continue to recognize revenues associated with our cloud services ratably over the term of the agreement. At the beginning of each period, we cannot predict the ratio of orders with revenues that will be recognized upfront and those with revenues that will be recognized ratably that we will enter into during the quarter. Our operating results and business model could also be significantly impacted by shifts over time in the percentage of term licenses and agreements for our cloud services we receive for our offerings and the duration of these types of agreements for our offerings. Term licenses and cloud services agreements have shorter contract duration than perpetual licenses, and the shift away from perpetual license sales could cause fluctuations in our operating results. In addition, the size of our licenses varies greatly, and a single, large perpetual or term license in a given period could distort our operating results. The timing and size of large orders are often hard to predict in any particular period. Further, a portion of revenue recognized in any given quarter is a result of ratably recognized agreements entered into during previous quarters, including agreements for our cloud services and maintenance and support agreements. Consequently, a decline in business from such ratably recognized agreements in any quarter may not be reflected in our revenue results for that quarter. Any such decline, however, will negatively affect our revenues in future quarters. Accordingly, the effect of downturns in sales and market acceptance of our offerings may not be fully reflected in our results of operations until future periods. Comparing our revenues and operating results on a period-to-period basis may not be meaningful, and our past results should not be relied upon as an indication of our future performance.

We may not be able to accurately predict our future revenues or results of operations. In particular, approximately half of the revenues we currently recognize each quarter has been attributable to sales made in that same quarter with the balance of the revenues being attributable to sales made in prior quarters in which the related revenues were not recognized upfront. As a result, our ability to forecast revenues on a quarterly or longer-term basis is extremely limited. We base our current and future expense levels on our operating plans and sales forecasts, and our operating costs are expected to be relatively fixed in the short-term. As a result, we may not be able to reduce our costs sufficiently to compensate for an unexpected shortfall in revenues, and even a small shortfall in revenues could disproportionately and adversely affect our financial results for that quarter.

In addition to other risk factors described elsewhere in this “Risk Factors” section, factors that may cause our financial results to fluctuate from quarter to quarter include:

- the timing of our sales during the quarter, particularly because a large portion of our sales occur toward the end of the quarter, or the loss or delay of a few large contracts;

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- the mix of revenues attributable to larger transactions as opposed to smaller transactions and the impact that a change in mix may have on the overall average selling price ("ASP") of our offerings;
- the mix of revenues attributable to perpetual and term licenses, agreements for our cloud services, enterprise adoption agreements, maintenance and professional services and training, which may impact our revenue, deferred revenue, billings, remaining performance obligations, gross margins and operating income;
- the renewal and usage rates of our customers;
- changes in the competitive dynamics of our market;
- changes in customers' budgets and in the timing of their purchasing decisions;
- changes in our pricing policies or those of our competitors;
- customers delaying purchasing decisions in anticipation of new offerings or software enhancements by us or our competitors;
- customer acceptance of and willingness to pay for new versions of our offerings or new solutions for specific product and end markets;
- our ability to successfully introduce and monetize new offerings and licensing and service models for our new offerings;
- network outages or actual or perceived security breaches;
- the availability and performance of our cloud services, including Splunk Cloud;
- our ability to control costs, including our operating expenses;
- the amount and timing of our stock-based compensation expenses;
- changes in accounting standards, particularly those related to revenue recognition and sales commissions;
- use of estimates, judgments and assumptions under current accounting standards;
- the timing of satisfying revenue recognition criteria;
- our ability to qualify and successfully compete for government contracts;
- the collectability of receivables from customers and resellers, which may be hindered or delayed;
- the removal of metered license enforcement via our software, which could lead to customers delaying renewal or purchasing decisions;
- changes in laws and regulations that impact our business; and

- general economic and political conditions and uncertainty, both domestically and internationally, as well as economic and political conditions and uncertainty specifically affecting industries in which our customers participate.

Many of these factors are outside our control, and the variability and unpredictability of such factors could result in our failing to meet or exceed our financial expectations for a given period. We believe that quarter-to-quarter comparisons of our revenues, operating results and cash flows may not necessarily be indicative of our future performance.

If we fail to effectively manage our growth, our business and operating results could be adversely affected.

Although our business has experienced significant growth, we cannot provide any assurance that our business will continue to grow at the same rate or at all. We have experienced and may continue to experience rapid growth in our headcount

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and operations, which has placed and will continue to place significant demands on our management and our operational and financial infrastructure. As of October 31, 2018, approximately 37% of our workforce had been employed by us for less than one year. As we continue to grow, we must effectively integrate, develop and motivate a large number of new employees, while maintaining the effectiveness of our business execution and the beneficial aspects of our corporate culture. In particular, we intend to continue to make directed and substantial investments to expand our research and development, sales and marketing, and general and administrative organizations, as well as our international operations.

To effectively manage growth, we must continue to improve our operational, financial and management controls, and our reporting systems and procedures by, among other things:

- improving our key business applications, processes and IT infrastructure to support our business needs;
- enhancing information and communication systems to ensure that our employees and offices around the world are well-coordinated and can effectively communicate with each other and our growing base of customers and channel partners;
- enhancing our internal controls to ensure timely and accurate reporting of all of our operations and financial results; and
- appropriately documenting our IT systems and our business processes.

These systems enhancements and improvements will require significant capital expenditures and allocation of valuable management and employee resources. If we fail to implement these improvements effectively, our ability to manage our expected growth, ensure uninterrupted operation of key business systems and comply with the rules and regulations that are applicable to public reporting companies will be impaired. Additionally, if we do not effectively manage the growth of our business and operations, the quality of our offerings could suffer, which could negatively affect our brand, financial results and overall business.

We face intense competition in our markets, and we may be unable to compete effectively for sales opportunities.

Although our offerings target the new and emerging market for software and cloud services that provide operational intelligence, we compete against a variety of large software vendors and smaller specialized companies, open source projects and custom development efforts, which provide solutions in the specific markets we address. Our principal competitors include:

- IT departments of potential customers which have undertaken custom software development efforts to analyze and manage their machine data;
- companies targeting the big data market by commercializing open source software, such as the various Hadoop distributions and NoSQL data stores, including Elastic;
- security, systems management and other IT vendors, including BMC Software, CA Technologies, Micro Focus, IBM, Intel, Microsoft and VMware;
- business intelligence vendors, analytics and visualization vendors, including IBM and Oracle; and
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cloud service providers, as well as small, specialized vendors that provide complementary and competitive solutions in enterprise data analytics, log aggregation and management, data warehousing and big data technologies that may compete with our offerings.

The principal competitive factors in our markets include features, performance and support, scalability and flexibility, ease of deployment and use, total cost of ownership and time to value. Some of our actual and potential competitors have advantages over us, such as longer operating histories, significantly greater financial, technical, marketing or other resources, stronger brand and business user recognition, larger intellectual property portfolios, broader global distribution and presence and more developed ecosystems of partners and skilled users. Further, competitors may be able to offer products or functionality similar to ours at a more attractive price than we can, such as by integrating or bundling their software products with their other product offerings. In addition, our industry is evolving rapidly and is becoming increasingly competitive. Larger and more established companies may focus on operational intelligence and could directly compete with us. For example, companies may commercialize open source software, such as Hadoop or Elasticsearch, in a manner that competes with our offerings or causes potential customers to believe that such product and our offerings perform the same function. If companies move a greater proportion of their data and computational needs to the cloud, new competitors may emerge that offer services comparable to ours or that are better suited for cloud-based data, and the demand for our offerings may decrease. Smaller companies could also launch new products and services that we do not offer and that could gain market acceptance quickly.

In recent years, there have been significant acquisitions and consolidation by and among our actual and potential competitors. We anticipate this trend of consolidation will continue, which will present heightened competitive challenges to our business. In particular, consolidation in our industry increases the likelihood of our competitors offering bundled or integrated products, and we believe that it may increase the competitive pressures we face with respect to our offerings. If we are unable to differentiate our offerings from the integrated or bundled products of our competitors, such as by offering enhanced functionality, performance or value, we may see decreased demand for those offerings, which would adversely affect our business operations, financial results and growth prospects. Further, it is possible that continued industry consolidation may impact customers' perceptions of the viability of smaller or even medium-sized software firms and consequently their willingness to use software solutions from such firms. Similarly, if customers seek to concentrate their software license purchases in the product portfolios of a few large providers, we may be at a competitive disadvantage regardless of the performance and features of our offerings. We believe that in order to remain competitive at the large enterprise level, we will need to develop and expand relationships with resellers and large system integrators that provide a broad range of products and services. If we are unable to compete effectively, our business operations and financial results could be materially and adversely affected.

Because our business substantially depends on sales of licenses, maintenance and services related to one software product, failure of this offering to satisfy customer demands or to achieve increased market acceptance would adversely affect our results of operations, financial condition and growth prospects.

Although we have several software and services offerings, our business substantially depends on, and we expect our business to continue to substantially depend on, sales of licenses, maintenance and services related to Splunk Enterprise. As such, the market acceptance of Splunk Enterprise is critical to our continued success. Demand for Splunk Enterprise is affected by a number of factors beyond our control, including continued market acceptance of Splunk Enterprise by referenceable accounts for existing and new use cases, the timing of development and release of new products by our competitors, technological change, and growth or contraction in our market. We expect the proliferation of machine data to lead to an increase in the data analysis demands of our customers, and our offerings may not be able to scale and perform to meet those demands or may not be chosen by users for those needs. If we are unable to continue to meet customer demands or to achieve more widespread market acceptance of Splunk Enterprise, our business operations, financial results and growth prospects will be materially and adversely affected.

We have a history of losses, and we may not be profitable in the future.

We have incurred net losses in each year since our inception. As a result, we had an accumulated deficit of $1.23 billion at October 31, 2018. Because the market for our offerings is rapidly evolving and has not yet reached widespread adoption, it is difficult for us to predict our future operating results. We expect our operating expenses to increase over the next several years as we hire additional personnel, expand and improve the effectiveness of our distribution channels, improve the performance and scalability of our technology architecture, and continue to develop features and functionality for our offerings. In addition, as we grow as a public company, we have incurred and will continue to incur significant legal, accounting and other operating expenses. If our revenues do not increase to offset these increases in our operating expenses, we may not be profitable in future periods. Our historical revenue growth has been inconsistent and should not be considered indicative of our future performance. Further, in future periods, our revenue growth could slow, or our revenues could decline for a number of reasons, including slowing demand for our offerings, increasing competition, a decrease in the growth of our overall market, or our failure, for any reason, to continue to capitalize on growth opportunities. Any failure by us to achieve, sustain or increase profitability on a consistent basis could cause the value of our common stock to decline.

If customers do not expand their use of our offerings beyond the current predominant use cases, our ability to grow our business and operating results may be adversely affected.

Most of our customers currently use our offerings to support application management, IT operations, security and compliance functions. Our ability to grow our business depends in part on our ability to help enable current and future customers to increase their use of our offerings for their existing use cases and expand their use of our offerings to additional use cases, such as facilities management, supply chain management, business analytics, IoT and customer analytics. If we fail to achieve market acceptance of our offerings for these applications, if our customers are not satisfied with our offerings, or if a competitor establishes a more widely adopted solution for these applications, our ability to grow our business and financial results will be adversely affected.

We employ multiple, unique and evolving pricing models, which subject us to various pricing and licensing challenges that could make it difficult for us to derive value from our customers and may adversely affect our operating results.

We employ multiple, unique and evolving pricing models for our offerings. For example, we generally charge our customers for their use of Splunk Enterprise and Splunk Light based on their estimated peak daily indexing capacity. In addition, Splunk Cloud is generally priced based on peak daily indexing capacity and data storage and Splunk Analytics for Hadoop is priced by the number of TaskTracker Nodes (Compute Nodes in YARN) in the respective Hadoop cluster while Splunk User Behavior Analytics is priced by the number of monitored user and system accounts. We offer both perpetual and term licensing options for on-premises offerings, as well as a subscription model for cloud services, which each have different payment schedules, and depending on the mix of such licenses and cloud subscriptions, our revenues or deferred revenues could be adversely affected. Our pricing models may ultimately result in a higher total cost to our customers generally as data volumes increase over time, or may cause our customers to limit or decrease usage in order to stay within the limits of their existing licenses or lower their costs, making it more difficult for us to compete in our markets or negatively impacting our financial results. As the amount of machine data within our customers' organizations grows, we face downward pressure from our customers regarding our pricing, which could adversely affect our revenues and operating margins. In addition, our unique pricing models may allow competitors with different pricing models to attract customers unfamiliar or uncomfortable with our pricing models, which would cause us to lose business or modify our pricing models, both of which could adversely affect our revenues and operating margins. While we introduced enterprise adoption agreements to provide pricing predictability to our customers, we have limited experience selling this type of license and our customers may not find this type of license attractive. We have also introduced variations to our pricing models, including but not limited to, pricing programs that provide broader usage and cost predictability as well as tiered pricing based on deployment models, data source types, compute and storage units and customer environments. Although we believe that these pricing models will drive net new customers and customer adoption, it is possible that they will not and may potentially cause confusion with our customers, which could negatively impact our financial results.

Furthermore, while our offerings can measure and limit customer usage, we recently removed metered license enforcement via our software under certain circumstances, and in other circumstances, such limitations may be improperly circumvented or otherwise bypassed by users. Similarly, we provide our customers with an encrypted license key for enabling their use of our offerings. There is no guarantee that users of our offerings will abide by the terms of these license limitations or encrypted license keys, and if they do not, we may not be able to capture the full value for the use of our offerings. For example, our enterprise license is generally meant for our customers' internal use only. If our internal use customers improperly make our offerings available to their customers or other third parties, for example, through a cloud or managed service offering not authorized by us, it may displace our end user sales. Additionally, if an internal use customer that has received a volume discount from us improperly makes available our offerings to its end customers, we may experience price erosion and be unable to capture the appropriate value from those end customers.

Our license agreements generally provide that we can audit our customers' use of our offerings or require them to certify their actual usage to ensure compliance with the terms of our license agreement at our request. However, a customer 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 under the license agreement, which would require us to spend money, distract management and potentially adversely affect our relationship with our customers and users.

The market for our offerings is new and unproven and may not grow.

We believe our future success will depend in large part on the growth, if any, in the market for offerings that provide operational intelligence, particularly from machine data. We market our offerings as targeted solutions for specific use cases and as an enterprise solution for machine data. In order to grow our business, we intend to expand the functionality of our offerings to increase their acceptance and use by the broader market as well as develop new offerings. It is difficult to predict customer adoption and renewal rates, customer demand for our offerings, the size and growth rate of this market, the entry of competitive products or the success of existing competitive products. Any expansion in our market depends on a number of factors, including the cost, performance and perceived value associated with our offerings. If our offerings do not achieve widespread adoption or there is a reduction in demand for products in our market caused by a lack of customer acceptance or expansion, technological challenges, security concerns, decreases in accessible machine data, competing technologies and products, pricing pressure, decreases in corporate or information technology spending, weakening economic conditions, or otherwise, it could result in reduced customer orders, early terminations, reduced renewal rates or decreased revenues, any of which would adversely affect our business operations and financial results. We believe that these are inherent risks and difficulties in this new and unproven market.

We have a short operating history, which makes it difficult to evaluate our future prospects and may increase the risk that we will not be successful.

We have a short operating history, which limits our ability to forecast our future operating results and subjects us to a number of uncertainties, including our ability to plan for and model future growth. We have encountered and will continue to encounter risks and uncertainties frequently experienced by growing companies in developing industries. If our assumptions regarding these uncertainties, which we use to plan our business, are incorrect or change in reaction to changes in our markets, 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. Moreover, although we have experienced rapid growth historically, we may not continue to grow as rapidly in the future. Any success that we may experience in the future will depend in large part on our ability to, among other things:

- improve the performance and capabilities of our offerings and technology and architecture through research and development;
- continue to develop, enhance, expand adoption of and globally deliver our cloud services, including Splunk Cloud, and comply with applicable laws in each jurisdiction in which we offer such services;
- successfully develop, introduce and expand adoption of new offerings;
- continue to acquire new customers and increase the number of new customers we acquire;
- increase revenues from existing customers through increased or broader use of our offerings within their organizations;
- successfully and continuously expand our business domestically and internationally;
- maintain and expand our customer base and the ways in which our customers use our offerings;
- successfully compete with other companies, open source projects and custom development efforts that are currently in, or may in the future enter, the markets for our offerings;
- successfully provide our customers a compelling business case to purchase our offerings in a time frame that matches our and our customers’ sales and purchase cycles and at a compelling price point;
- respond timely and effectively to competitor offerings and pricing models;
- appropriately price our offerings;
- manage the costs of providing our cloud services;
- generate leads and convert users of the trial versions of our offerings to paying customers;
- prevent users from circumventing the terms of their licenses and cloud subscriptions;
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continue to invest in our platform to deliver additional enhancements and content for our offerings and to foster an ecosystem of developers and users to expand the use cases of our offerings;

- maintain and enhance our website and cloud services infrastructure to minimize interruptions when accessing our offerings;

- process, store and use our employees, customers' and other third parties' data in compliance with applicable governmental regulations and other legal obligations related to data privacy, data protection, data transfer, data residency, encryption and security;

- hire, integrate and retain world-class professional and technical talent; and

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• successfully integrate acquired businesses and technologies.

If we fail to address the risks and difficulties we face, including those described elsewhere in this "Risk Factors" section, our business will be adversely affected and our business operations and financial results will suffer.

Our business and growth depend substantially on customers entering into and renewing their term licenses, agreements for cloud services and maintenance and support agreements with us. Any decline in our customer renewals could adversely affect our future operating results.

While much of our software is sold under perpetual license agreements, all of our maintenance and support agreements are sold on a term basis. In addition, we also enter into renewable term license agreements for our on-premises offerings and agreements for our cloud services. In order for us to improve our operating results, it is important that customers enter into renewable agreements, and our existing customers renew their term licenses, agreements for cloud services and maintenance and support agreements when the contract term expires. Our customers have no obligation to renew their term licenses, agreements for cloud services or maintenance and support agreements with us after the terms have expired. Our customers' renewal rates may decline or fluctuate as a result of a number of factors, including their satisfaction or dissatisfaction with our offerings, our pricing, the effects of economic conditions, competitive offerings or alterations or reductions in our customers' spending levels. If our customers do not renew their agreements with us or renew on terms less favorable to us, our revenues may decline.

If we do not effectively expand, train and manage changes to our sales force, we may be unable to add new customers or increase sales to our existing customers, and our revenue growth and business could be adversely affected.

We continue to be substantially dependent on our sales force to effectively execute our sales strategies to obtain new customers and to drive additional use cases and adoption among our existing customers. We believe that there is significant competition for sales personnel with the skills and technical knowledge that we require. Our ability to achieve significant revenue growth will depend, in large part, on our success in recruiting, training and retaining sufficient numbers of sales personnel to support our growth. New hires require significant training and may take a significant amount of time before they achieve full productivity. Our recent hires and planned hires may not become productive as quickly as we expect, and we may be unable to hire or retain sufficient numbers of qualified individuals in the markets where we do business or plan to do business. In addition, as we continue to grow rapidly, a large percentage of our sales force is new to the company and our offerings. As our sales strategies evolve, additional training for new hires and our existing team may be required for our sales force to successfully execute on those strategies. We periodically adjust our sales organization as part of our efforts to optimize our sales operations to grow revenue. If we have not structured our sales organization or compensation for our sales organization properly, if we fail to make changes in a timely fashion or do not effectively manage changes, our revenue growth could be adversely affected. Our growth creates additional challenges and risks with respect to attracting, integrating and retaining qualified employees, particularly sales personnel. If we are unable to hire and train sufficient numbers of effective sales personnel, or the sales personnel are not successful in obtaining new customers or increasing sales to our existing customer base, our business will be adversely affected.

Our sales cycle is long and unpredictable, particularly with respect to large customers, and our sales efforts require considerable time and expense.

Our operating results may fluctuate, in part, because of the resource intensive nature of our sales efforts, the length and variability of the sales cycle of our offerings and the short-term difficulty in adjusting our operating expenses. Our operating results depend in part on sales to large customers. The length of our sales cycle, from initial evaluation to delivery of and payment for the software license, varies substantially from customer to customer. In addition, the introduction of Splunk Cloud has generated interest from our customers who are also considering purchasing and deploying Splunk Enterprise on-premises. In some cases, our customers may wish to consider a combination of these offerings, potentially further slowing our sales cycle. Our sales cycle can extend to more than a year for certain customers, particularly large customers. It is difficult to predict exactly when, or even if, we will make a sale with a potential customer or if a user of a trial version of one of our offerings will upgrade to the paid version of that offering. As a result, large individual sales have, in some cases, occurred in quarters subsequent to those we anticipated, or have not occurred at all. The loss or delay of one or more large transactions in a quarter could impact our operating results for that quarter and any future quarters for which revenues from that transaction is delayed. As a result of these factors, it is difficult for us to forecast our revenues accurately in any quarter. Because a substantial portion of our expenses are relatively fixed in the short-term, our operating results will suffer if revenues fall below our expectations in a particular quarter, which could cause the price of our common stock to decline.

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

During the three months ended October 31, 2018, we derived approximately 24% of our total revenues from customers outside the United States, and we are continuing to expand our international operations as part of our growth strategy. We currently have sales personnel and sales and support operations in the United States and certain countries around the world. To the extent that we experience difficulties in recruiting, training, managing, or retaining non-U.S. staff, and specifically sales management and sales personnel staff, we may experience difficulties in sales productivity in, or market penetration of, non-U.S. markets. Additionally, our sales organization outside the United States is substantially smaller than our sales organization in the United States, and we rely heavily on our sales channel for non-U.S. sales. Our ability to convince customers to expand their use of our offerings or renew their maintenance and support agreements with us is directly correlated to our direct engagement with the customer. To the extent we are unable to engage with non-U.S. customers effectively with our limited sales force, professional services and support capacity or our indirect sales model, we may be unable to grow sales to existing customers to the same degree we have experienced in the United States.

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

- increased management, travel, infrastructure and legal compliance costs associated with having multiple international operations;
- reliance on channel partners;
- longer payment cycles and difficulties in collecting accounts receivable or satisfying revenue recognition criteria, especially in emerging markets;
- increased financial accounting and reporting burdens and complexities;
- general economic conditions in each country or region;
- economic and political uncertainty around the world, such as the uncertainty regarding U.S. foreign and domestic policy and the United Kingdom’s referendum in June 2016 in which voters approved an exit from the European Union (“EU”), commonly referred to as “Brexit”;
- compliance with multiple and changing foreign laws and regulations, including those governing employment, tax, privacy and data protection, data transfer and the risks and costs of non-compliance with such laws and regulations;
- compliance with laws and regulations for foreign operations, including the United States Foreign Corrupt Practices Act, the United Kingdom Bribery Act, import and export control laws, tariffs, trade barriers, economic sanctions and other regulatory or contractual limitations on our ability to sell our offerings in certain foreign markets, and the risks and costs of non-compliance, including as a result of any changes in trade relations, sanctioned parties or other restrictions;
- heightened risks of unfair or corrupt business practices in certain geographies and of improper or fraudulent sales arrangements that may impact financial results and result in restatements of financial statements and irregularities in financial statements;
- fluctuations in currency exchange rates and the related effect on our financial results;

- difficulties in repatriating or transferring funds from or converting currencies in certain countries;
- the need for localized software and licensing programs;
- reduced protection for intellectual property rights in some countries and practical difficulties of enforcing intellectual property and contract rights abroad; and
- compliance with the laws of numerous foreign taxing jurisdictions and overlapping of different tax regimes.

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

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In addition, compliance with laws and regulations applicable to our international operations increases our cost of doing business in foreign jurisdictions. We may be unable to keep current with changes in foreign government requirements and laws 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 United States regulations applicable to us. In addition, 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, channel partners and agents will comply with these laws and policies. Violations of laws or key control policies by our employees, contractors, channel partners or agents could result in delays in revenue recognition, financial reporting misstatements, fines, penalties, or the prohibition of the importation or exportation of our offerings and could have a material adverse effect on our business operations and financial results.

If we are unable to maintain successful relationships with our channel partners, and to help our channel partners enhance their ability to independently sell and deploy our offerings, our business operations, financial results and growth prospects could be adversely affected.

In addition to our direct sales force, we use indirect channel partners, such as distributors and resellers, to license, provide professional services and support our offerings. We derive a portion of our revenues from sales of our offerings through our channel partners, particularly in the Europe, Middle East and Africa, or EMEA, and Asia Pacific, or APAC, regions and for sales to government agencies. We expect that sales through channel partners in all regions will continue to grow as a portion of our revenues for the foreseeable future. As changes in our channel strategy are implemented, including potentially emphasizing partner-sourced transactions, results from sales through our channel partners may be adversely affected.

Our agreements with our channel partners are generally non-exclusive, meaning our channel partners may offer customers the products of several different companies, including products that compete with ours. If our channel partners do not effectively market and sell our offerings, choose to use greater efforts to market and sell their own products or those of our competitors, or fail to meet the needs of our customers, our ability to grow our business and sell our offerings may be adversely affected. Our channel partners may cease marketing our offerings with limited or no notice and with little or no penalty. The loss of a substantial number of our channel partners, our possible inability to replace them, or the failure to recruit additional channel partners could materially and adversely affect our results of operations. In addition, sales by channel partners are more likely than direct sales to involve collectability concerns, in particular sales by our channel partners in developing markets, and accordingly, variations in the mix between revenues attributable to sales by channel partners and revenues attributable to direct sales may result in fluctuations in our operating results.

Our ability to achieve revenue growth in the future will depend in part on our success in maintaining successful relationships with our channel partners, and to help our channel partners enhance their ability to independently sell and deploy our offerings. In order to achieve these objectives, we may be required to adjust our incentives, pricing or discount programs for our channel partners, which could adversely affect our operating results. If we are unable to maintain our relationships with these channel partners, or otherwise develop and expand our indirect distribution channel, our business, results of operations, financial condition or cash flows could be adversely affected.

Incorrect or improper implementation or use of our software could result in customer dissatisfaction, customer data loss or corruption and negatively affect our business, operations, financial results and growth prospects.

Our software is deployed in a wide variety of technology environments. Increasingly, our software has been deployed in large scale, complex technology environments, and we believe our future success will depend on our ability to increase sales of our software licenses for use in such deployments. We often must assist our customers in achieving successful implementations for large, complex deployments. If we or our customers are unable to implement our software successfully, are unable to do so in a timely manner or if an improper implementation or change in system configuration results in errors or loss of data, customer perceptions of our company may be impaired, our reputation and brand may suffer, and customers may choose not to increase their use of our offerings. In addition, our software imposes server load and index storage requirements for implementation. If our customers do not have the server load capacity or the storage capacity required, they may not be able to effectively implement and use our software and, therefore, may not choose to increase their use of our offerings.

Our customers and third-party partners may need training in the proper use of and the variety of benefits that can be derived from our software to maximize its potential. If our software is not implemented or used correctly or as intended, inadequate performance, errors, data loss or corruption may result. Because our customers rely on our software and maintenance and support services to manage a wide range of operations, the incorrect or improper implementation or use of our software, our failure to train customers on how to efficiently and effectively use our software, or our failure to provide

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maintenance services 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 follow-on sales of our offerings.

If we or our third-party service providers experience a security breach or unauthorized parties otherwise obtain access to our customers' data, our data, or our cloud services, our offerings may be perceived as not being secure, our reputation may be harmed, demand for our offerings may be reduced, and we may incur significant liabilities.

Our offerings involve the storage and transmission of data, and security breaches could result in the loss of this information, litigation, indemnity obligations and other liability. We may become the target of cyber-attacks by third parties seeking unauthorized access to our data or users' data or to disrupt our ability to provide service. While we have taken steps to protect the confidential information that we have access to, including confidential information we may obtain through our customer support services or customer usage of our cloud services, our security measures or those of our third-party service providers could be breached or we could suffer data loss. Computer malware, viruses, social engineering (predominantly spear phishing attacks), and general hacking have become more prevalent in our industry, particularly against cloud services. In the first quarter of fiscal 2019, we took corrective action against an attacker who utilized compromised credentials to create and delete compute infrastructure in the Splunk Cloud environment. In addition, we do not directly control content that customers store in our offerings. If customers use our offerings for the transmission or storage of personally identifiable information and our security measures are or are believed to have been breached as a result of third-party action, employee error, malfeasance or otherwise, our reputation could be damaged, our business may suffer, and we could incur significant liability.

We also process, store and transmit our own data as part of our business and operations. This data may include personally identifiable, confidential or proprietary information. There can be no assurance that any security measures that we or our third-party service providers have implemented will be effective against current or future security threats. While we have developed systems and processes to protect the integrity, confidentiality and security of our data, our security measures or those of our third-party service providers could fail and result in unauthorized access to or disclosure, modification, misuse, loss or destruction of such data.

Because there are many different security breach techniques and such techniques continue to evolve, we may be unable to anticipate attempted security breaches and implement adequate preventative measures. Third parties may also conduct attacks designed to temporarily deny customers access to our cloud services. Any security breach or other security incident, or the perception that one has occurred, could result in a loss of customer confidence in the security of our offerings and damage to our brand, reduce the demand for our offerings, disrupt normal business operations, require us to spend material resources to investigate or correct the breach, expose us to legal liabilities, including litigation, regulatory enforcement, and indemnity obligations, and adversely affect our revenues and operating results. These risks may increase as we continue to grow the number and scale of our cloud services, and process, store, and transmit increasingly large amounts of data.

We use third-party technology and systems for a variety of reasons, including, without limitation, encryption and authentication technology, employee email, content delivery to customers, back-office support, credit card processing and other functions. Although we have developed systems and processes that are designed to protect customer information and prevent data loss and other security breaches, including systems and processes designed to reduce the impact of a security breach at a third-party vendor, such measures cannot provide absolute security.

Interruptions or performance problems associated with our technology and infrastructure, and our reliance on Software-as-a-Service ("SaaS") technologies from third parties, may adversely affect our business operations and financial results.

Our continued growth depends in part on the ability of our existing and potential customers to use and access our website or our cloud services in order to download our on-premises software or encrypted access keys for our software within an acceptable amount of time. We have experienced, and may in the future experience, website and cloud service disruptions, storage failures, outages and other performance problems due to a variety of factors, including infrastructure changes, human or software errors, capacity constraints due to an overwhelming number of users accessing our website and services simultaneously, unauthorized access, denial of service, security or ransomware attacks. In some instances, we may not be able to identify the cause or causes of these website or service performance problems within an acceptable period of time. It may become increasingly difficult to maintain and improve our website and service performance, especially during peak usage times and as our offerings become more complex and our user traffic increases. If our website or cloud services are unavailable or if our users are unable to download our software or encrypted access keys within a reasonable amount of time or at all, our business would be negatively affected. We expect to continue to make significant investments to maintain and improve website and service performance and to enable rapid releases of new features and apps for our offerings. 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.

In addition, we rely heavily on hosted SaaS technologies from third parties in order to operate critical functions of our business, including enterprise resource planning services and customer relationship management services. Further, our cloud services, such as Splunk Cloud, are hosted exclusively by third parties. We currently offer a 100% uptime service level agreement ("SLA") for Splunk Cloud. If any of these services fail or become unavailable due to extended outages, interruptions or because they are no longer available on commercially reasonable terms or prices, or if we are unable to deliver 100% uptime under our SLAs, our revenues could be reduced, our reputation could be damaged, we could be exposed to legal liability, expenses could increase, our ability to manage our finances could be interrupted and our processes for managing sales of our offerings 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.

Our systems and third-party systems upon which we rely are also vulnerable to damage or interruption from catastrophic occurrences such as earthquakes, floods, fires, power loss, telecommunication failures, terrorist attacks, criminal acts, sabotage, other intentional acts of vandalism and misconduct, geopolitical events and similar events. Our United States corporate offices and certain of the facilities we lease to house our computer and telecommunications equipment are located in the San Francisco Bay Area, a region known for seismic activity. Despite any precautions we may take, the occurrence of a natural disaster or other unanticipated problems at our and our third parties' hosting facilities could result in interruptions, performance problems or failure of our infrastructure.

Splunk Cloud, as well as cloud services for other products, are relatively new offerings, require costly and continual infrastructure investments, and market adoption of these cloud services could adversely affect our business.

A cloud-based model of software deployment is one in which a software provider typically licenses an application to customers for use as a service on demand through web browser technologies. Delivering software under a cloud-based model results in higher costs and expenses when compared to sales of on-premises licenses for similar functionality. In recent years, companies have begun to expect that key software, such as customer relationship management and enterprise resource planning systems, be provided through a cloud-based model. Many of our offerings are now made available in the cloud as well as on-premises. Customers can sign up for Splunk Cloud and other services and avoid the need to provision, deploy and manage internal infrastructure. In order to provide Splunk Cloud and other services via a cloud-based deployment, we have made and will continue to make capital investments and incur substantial costs to implement and maintain this alternative business model, which could negatively affect our financial results. In addition, as we look to deliver more cloud services, we are making significant technology investments to deliver new capabilities and advance our software to deliver cloud-native customer experiences. If we are not successful with returns from these investments, our financial results, business model and competitive position could suffer. We expect that over time the percentage of our revenue attributable to our cloud services will increase. If our cloud services, in particular Splunk Cloud, do not garner widespread market adoption, or there is a reduction in demand for cloud-based services caused by a lack of customer acceptance, technological challenges, weakening economic or political conditions, security or privacy concerns, inability to properly manage such services, competing technologies and products, decreases in corporate spending or otherwise, our financial results, business model and competitive position could suffer. If we are unable to decrease the cost of providing our cloud services, our gross margins may decrease and negatively impact our overall financial results. Transitioning to a cloud-based model also impacts the way we recognize revenues, which may affect our operating results and could have an adverse effect on our business operations and financial results.

Even with these investments and costs, the cloud-based business model for Splunk Cloud and other services may not be successful, as some customers may desire only on-premises licenses to our offerings. Our cloud services may raise concerns among customers, including concerns regarding changes to pricing models, service availability, scalability,

ability to use customer-developed apps, information security of a cloud-based service and hosted data and access to data while offline or once a subscription has expired. Market acceptance of our cloud services can be affected by a variety of factors, including but not limited to: security, reliability, performance, terms of service, support terms, customer preference, community engagement, customer concerns with entrusting a third party to store and manage their data, public concerns regarding data privacy and the enactment of restrictive laws or regulations in the affected jurisdictions. If we or other providers of cloud-based services experience security incidents or breaches, loss of customer data, disruptions in delivery of services, network outages, disruptions in availability of the internet, unauthorized access or other problems, the market for cloud-based services as a whole, including Splunk Cloud, may be negatively affected. Moreover, sales of Splunk Cloud and other services could displace sales of our on-premises software licenses. Alternatively, subscriptions to Splunk Cloud and other services that exceed our expectations may unexpectedly increase our costs, lower our margins, lower our profits or increase our losses and otherwise negatively affect our projected financial results.

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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.

Our offerings are subject to United States export controls, and we incorporate encryption technology into certain of our offerings. These encryption offerings and the underlying technology may be exported outside of the United States only with the required export authorizations, including by license.

Furthermore, our activities are subject to the U.S. economic sanctions laws and regulations that prohibit the shipment of certain products and services without the required export authorizations or export to countries, governments, and persons targeted by U.S. sanctions. While we take precautions to prevent our offerings from being exported in violation of these laws, including obtaining authorizations for our encryption offerings, implementing IP address blocking and screenings against U.S. Government and international lists of restricted and prohibited persons, we cannot guarantee that the precautions we take will prevent violations of export control and sanctions laws. For example, downloads of our free software may have in the past been made in potential violation of the export control and economic sanctions laws.

We also note that 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 export control compliance requirements in our channel partner agreements. 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.

Violations of U.S. sanctions or export control laws can result in fines or penalties, including civil penalties of up to $250,000 or twice the value of the transaction, whichever is greater, per violation. In the event of criminal knowing and willful violations of these laws, fines of up to $1 million per violation and possible incarceration for responsible employees and managers could be imposed.

During the pendency of our acquisition of VictorOps, we discovered a small number of instances where the software as a service platform was accessed (or attempted to be accessed) from IP addresses potentially located in embargoed countries. VictorOps filed an initial voluntary disclosure with the U.S. Treasury Department's Office of Foreign Assets Control (“OFAC”) in June 2018 to alert the agency to these potential violations. After completion of the acquisition, we conducted an internal investigation into these potential violations and filed a Final Voluntary Disclosure with OFAC with respect to these matters in November 2018. At this time, the agency has not completed its review.

Also, various countries, in addition to the United States, regulate the import and export of certain encryption and other technology, including import and export permitting and licensing requirements, and have enacted laws that could limit our ability to distribute our offerings or could limit our customers’ ability to implement our offerings in those countries. Changes in our offerings or future changes in export and import regulations may create delays in the introduction of our offerings in international markets, prevent our customers with international operations from deploying our offerings globally or, in some cases, prevent the export or import of our offerings to certain countries, governments, or persons altogether. 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 offerings by, or in our decreased ability to export or sell our offerings to, existing or potential customers with international operations. Any decreased use of our offerings or limitation on our ability to export or sell our offerings would likely adversely affect our business operations and financial results.

If our new offerings and product enhancements do not achieve sufficient market acceptance, our financial results and competitive position will suffer.

We spend substantial amounts of time and money to research and develop new offerings and enhanced versions of our existing offerings to incorporate additional features, improve functionality or other enhancements in order to meet our customers' rapidly evolving demands. In addition, we continue to invest in solutions that can be deployed on top of our platform to target specific use cases and to cultivate our community of application developers and users. When we develop a new or enhanced version of an existing offering, we typically incur expenses and expend resources upfront to market, promote and sell the new offering. Therefore, when we develop and introduce new or enhanced offerings, they must achieve high levels of market acceptance in order to justify the amount of our investment in developing and bringing them to market. For example, if our cloud services such as Splunk Cloud do not garner widespread market adoption and implementation, our financial results and competitive position could suffer.

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Further, we may make changes to our offerings that our customers do not like, find useful or agree with. We may also discontinue certain features, begin to charge for certain features that are currently free or increase fees for any of our features or usage of our offerings.

Our new offerings or product enhancements and changes to our existing offerings could fail to attain sufficient market acceptance for many reasons, including:

- our failure to predict market demand accurately in terms of product functionality and to supply offerings that meet this demand in a timely fashion;
- defects, errors or failures;
- negative publicity about their performance or effectiveness;
- delays in releasing to the market our new offerings or enhancements to our existing offerings to the market;
- introduction or anticipated introduction of competing products by our competitors;
- poor business conditions for our end-customers, causing them to delay IT purchases; and
- reluctance of customers to purchase products incorporating open source software.

If our new offerings or enhancements and changes do not achieve adequate acceptance in the market, our competitive position will be impaired, and our revenues will be diminished. The adverse effect on our financial results may be particularly acute because of the significant research, development, marketing, sales and other expenses we will have incurred in connection with the new offerings or enhancements.

Our business depends, in part, on sales to the public sector, and significant changes in the contracting or fiscal policies of the public sector could have a material adverse effect on our business.

We derive a portion of our revenues from contracts with federal, state, local and foreign governments, and we believe that the success and growth of our business will continue to depend on our successful procurement of government contracts. Factors that could impede our ability to maintain or increase the amount of revenues derived from government contracts, include:

- changes in fiscal or contracting policies;
- decreases in available government funding;
- changes in government programs or applicable requirements;
- changes in government sanctions programs and related policies;
- the adoption of new laws or regulations or changes to existing laws or regulations;
- noncompliance with contract provisions or government procurement or other applicable regulations;
- ability to obtain or maintain any required facility clearances or security clearances for our employees;

- potential delays or changes in the government appropriations or other funding authorization processes; and

- delays in the payment of our invoices by government payment offices.

The occurrence of any of the foregoing could cause governments and governmental agencies to delay or refrain from purchasing licenses of our offerings in the future or otherwise have an adverse effect on our business operations and financial results.

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Failure to comply with laws or regulations applicable to our business could cause us to lose customers in the public sector, subject us to fines and penalties, or negatively impact our ability to contract with the public sector.

We must comply with laws and regulations relating to the formation, administration and performance of contracts with the public sector, including United States federal, state and local governmental bodies, which affect how our channel partners and how we do business with governmental agencies. These laws and regulations may impose added costs on our business, and failure to comply with these or other applicable regulations and requirements, including non-compliance in the past, could lead to claims for damages or other relief, penalties, termination of contracts, loss of exclusive rights in our intellectual property, and temporary suspension or permanent debarment from government contracting. Any such damages, penalties, disruptions or limitations in our ability to do business with the public sector could have a material adverse effect on our business operations and financial results.

Real or perceived errors, failures or bugs in our offerings could adversely affect our financial results and growth prospects.

Because our offerings are complex, undetected errors, failures or bugs may occur, especially when new offerings, versions or updates are released. Our on-premises software is often installed and used in large-scale computing environments with different operating systems, system management software, and equipment and networking configurations, which may cause errors or failures of our software or other aspects of the computing environment into which it is deployed. In addition, deployment of our software into complicated, large-scale computing environments may expose undetected errors, failures or bugs in our software. Despite testing by us, errors, failures or bugs may not be found in our offerings until they are released to our customers. In the past, we have discovered errors, failures and bugs in some of our offerings after their introduction. Real or perceived errors, failures or bugs in our offerings could result in negative publicity, loss of or delay in market acceptance of our offerings, loss of competitive position or claims by customers for 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.

In addition, if an actual or perceived failure of our software occurs in a customer’s deployment or in our cloud services, regardless of whether the failure is attributable to our software, the market perception of the effectiveness of our offerings could be adversely affected. Alleviating any of these problems could require significant expenditures of our capital and other resources and could cause interruptions, delays or cessation of our licensing, which could cause us to lose existing or potential customers and could adversely affect our financial results and growth prospects.

Failure to protect our intellectual property rights could adversely affect our business and our brand.

Our success and ability to compete depends, in part, on our ability to protect our trade secrets, trademarks, copyrights, patents, proprietary methods and technologies and other intellectual property that we develop under intellectual property laws of the United States and other jurisdictions outside of the United States so that we can prevent others from using our inventions and proprietary information and property. We generally rely on copyright, trade secret and trademark laws, trade secret protection and confidentiality or license agreements with our employees, consultants, vendors, customers, partners and others and generally limit access to and distribution of our proprietary information in order to protect our intellectual property rights. If we fail to protect our intellectual property rights adequately, our competitors might gain access to our technology or use of our brand, and our business might be adversely affected. However, defending our intellectual property rights might entail significant expenses. Any of our patent rights, copyrights, trademarks or other intellectual property rights may be challenged by others or invalidated through administrative process or litigation. Our issued patents and any patents issued in the future may not provide us with any competitive advantages, and our patent applications may never be granted. Additionally, the process of obtaining patent protection is expensive and time-consuming, and we may not be able to file and prosecute all necessary or desirable patent applications, or we may not be able to do so at a reasonable cost or in a timely manner. Even if issued, there can be no assurance that these patents will adequately protect our intellectual property, as the legal standards relating to the infringement, validity, enforceability and scope of protection of patent and other intellectual property rights are complex and often uncertain.

Any patents that are issued may subsequently be invalidated or otherwise limited, allowing other companies to develop offerings that compete with ours, which could adversely affect our competitive business position, business prospects and financial condition. In addition, issuance of a patent does not guarantee that we have a right to practice the patented invention. Patent applications in the United States are typically not published until 18 months after filing or, in some cases, not at all, and publications of discoveries in industry-related literature lag behind actual discoveries. We cannot be certain that we were the first to use the inventions claimed in our issued patents or pending patent applications or otherwise used in our offerings, that we were the first to file patent applications, or that third parties do not have blocking patents that could be used to prevent us from marketing or practicing our offerings or technology. Effective patent, trademark, copyright and trade secret protection may not be available to us in every country in which our offerings are available. The laws of some foreign countries may not be as protective of intellectual property rights as those in the United States (in particular, some foreign jurisdictions do not permit patent protection for software), and mechanisms for enforcement of intellectual property rights may be inadequate. Additional uncertainty may result from recent and future changes to intellectual property legislation in the United States (including the “America Invents Act”) and other countries and from interpretations of the intellectual property laws of the United States and other countries by applicable courts and agencies. Accordingly, despite our efforts, we may be unable to prevent third parties from infringing upon or misappropriating our intellectual property.

We rely in part on trade secrets, proprietary know-how and other confidential information to maintain our competitive position. Although we endeavor to enter into non-disclosure agreements with our employees, licensees and others who may have access to this information, we cannot assure that these agreements or other steps we have taken will prevent unauthorized use, disclosure or reverse engineering of our technology. In addition, the laws of some foreign countries do not protect our proprietary rights to as great an extent as the laws of the United States, and many foreign countries do not enforce these laws as diligently as government agencies and private parties in the United States. Moreover, third parties may independently develop technologies or products that compete with ours, and we may be unable to prevent this competition.

We might be required to spend significant resources to monitor and protect our intellectual property rights. We may initiate claims or litigation against third parties for infringement of our proprietary rights or to establish the validity of our proprietary rights. Litigation also puts our patents at risk of being invalidated or interpreted narrowly. Additionally, we may provoke third parties to assert counterclaims against us. We may not prevail in any lawsuits that we initiate, and the damages or other remedies awarded, if any, may not be adequate to compensate us for the harm suffered. Any litigation, whether or not it is resolved in our favor, could result in significant expense to us and divert the efforts of our technical and management personnel, which may adversely affect our business operations or financial results.

We have been, and may in the future be, subject to intellectual property rights claims by third parties, which are extremely costly to defend, could require us to pay significant damages and could limit our ability to use certain technologies.

Companies in the software and technology industries, including some of our current and potential competitors, own large numbers of patents, copyrights, trademarks and trade secrets and frequently enter into litigation based on allegations of infringement or other violations of intellectual property rights. In addition, many of these companies have the capability to dedicate substantially greater resources to enforce their intellectual property rights and to defend claims that may be brought against them. The litigation may involve patent holding companies or other adverse patent owners that have no relevant product revenues and against which our patents may therefore provide little or no deterrence. From time-to-time, third parties, including certain of these leading companies, have asserted and may assert patent, copyright, trademark or other intellectual property rights against us, our channel partners, our technology partners or our customers. We have received, and may in the future receive, notices that claim we have misappropriated, misused, or infringed other parties’ intellectual property rights, and, to the extent we gain greater market visibility, we face a higher risk of being the subject of intellectual property infringement claims, which is not uncommon with respect to the enterprise software market.

There may be third-party intellectual property rights, including issued or pending patents, that cover significant aspects of our technologies or business methods. We may be exposed to increased risk of being the subject of intellectual property infringement claims as a result of acquisitions, as, among other things, we have a lower level of visibility into the development process with respect to such technology or the care taken to safeguard against infringement risks. Any intellectual property claims, with or without merit, could be very time-consuming, could be expensive to settle or litigate and could divert our management's attention and other resources. These claims could also subject us to significant liability for damages, potentially including treble damages if we are found to have willfully infringed patents or copyrights. These claims could also result in our having to stop using technology found to be in violation of a third party's rights. We might be required to seek a license for the intellectual property, which may not be available on reasonable terms or at all. Even if a license were available, we could be required to pay significant royalties, which would increase our operating expenses. As a result, we may be required to develop alternative non-infringing technology, which could require significant effort and expense. If we cannot license or develop technology for any infringing aspect of our business, we would be forced to limit or stop sales of our offerings and may be unable to compete effectively. Any of these results would adversely affect our business operations and financial results.

We offer free trials, trial-to-buy and other next-generation go-to-market strategies, and we may not be able to realize the benefits of these strategies.

We offer trial version licenses, including online sandboxes, of certain of our offerings to users free of charge as part of our overall strategy of developing the market for offerings that provides operational intelligence and promoting additional penetration of our offerings in the markets in which we compete. Some users never convert from the trial version to the paid version. In fiscal 2017, we introduced free development-test licenses for certain commercial customers as part of our strategy to help enable such customers to expand their use of our offerings to additional use cases. In fiscal 2018, we began offering our cloud services through a cloud vendor marketplace. To the extent that users of our trial version do not become paying customers, our current customers do not expand their use of our offerings beyond the current predominant use cases, or we are unsuccessful in building effective go-to-market strategies for our offerings, we will not realize the intended benefits of these marketing strategies and our ability to grow our revenues will be adversely affected.

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

We believe that maintaining and enhancing the "Splunk" brand identity is critical to our relationships with our customers and channel partners and to our ability to attract new customers and channel partners. The successful promotion of our brand will depend largely upon our marketing efforts, our ability to continue to offer high-quality offerings and our ability to successfully differentiate our offerings from those of our competitors. Our brand promotion activities may not be successful or yield increased revenues. In addition, independent industry analysts often provide reviews of our offerings, as well as those of our competitors, and perception of our offerings 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.

Moreover, it may 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 revenues, these revenues 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 with stronger brands, and we could lose customers and channel partners, all of which would adversely affect our business operations and financial results.

Our future performance depends in part on proper use of our community website, Splunkbase, expansion of our developer ecosystem, and support from third-party software developers.

Our offerings enable third-party software developers to build apps on top of our platform. We operate a community website, Splunkbase, for sharing these third-party apps, including add-ons and extensions. While we expect Splunkbase to support our sales and marketing efforts, it also presents certain risks to our business, including:

- third-party developers may not continue developing or supporting the software apps that they share on Splunkbase;

- we cannot guarantee that if and as we change the architecture of our products and services, third-party developers will evolve their existing software apps to be compatible or that they will participate in the creation of new apps utilizing the new architecture;

- we cannot provide any assurance that these apps meet the same quality and security standards that we apply to our own development efforts, and, to the extent they contain bugs, defects or security vulnerabilities, they may create disruptions in our customers' use of our offerings or negatively affect our brand;

- we do not currently provide support for software apps developed by third-party software developers, and users may be left without support and potentially disappointed by their experience of using our offerings if the third-party software developers do not provide support for these apps;

- these third-party software developers may not possess the appropriate intellectual property rights to develop and share their apps or otherwise may not have assessed legal and compliance risks related to distributing their apps; and

- some of these developers may use the insight they gain using our offerings and from documentation publicly available on our website to develop competing products.

Many of these risks are not within our control to prevent, and our brand may be damaged if these apps, add-ons and extensions do not perform to our customers' satisfaction and that dissatisfaction is attributed to us.

Our use of "open source" software could negatively affect our ability to sell our offerings and subject us to possible litigation, and our participation in open source projects may impose unanticipated burdens or restrictions.

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We use open source software in our offerings and expect to continue to use open source software in the future. We may face claims from others alleging breach of license requirements or infringement of intellectual property rights in what we believe to be licensed open source software, or seeking to enforce the terms of an open source license, including by demanding release of our proprietary source code that was developed using, incorporating or linked with such open source software or by requiring that we apply open source licenses to our proprietary applications. 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 offerings, any of which would have a negative effect on our business and operating results. In addition, if the license terms for the open source code change, we may be forced to re-engineer our offerings or incur additional costs to find alternative tools. In addition to risks related to license requirements, usage of open source software can lead to greater risks than use of third-party commercial software, as open source licensors generally do not provide warranties, support, indemnity or assurance of title or controls on origin of the software. Likewise, some open source projects have known security and other vulnerabilities and architectural instabilities and are provided on an "as-is" basis. Additionally, because any software source code we contribute to open source projects is publicly available, our ability to protect our intellectual property rights with respect to such software source code may be limited or lost entirely, and we may be unable to prevent our competitors or others from using such contributed software source code. Many of these risks associated with usage of open source software, such as the lack of warranties, support or assurances of title, cannot be eliminated, and could, if not properly addressed, negatively affect the performance of our offerings and our business. While we have established processes to help alleviate these risks, we cannot assure that these measures will reduce or completely shield us from these risks.

We are subject to a number of legal requirements, contractual obligations and industry standards regarding security, data protection, and privacy and any failure to comply with these requirements, obligations or standards could have an adverse effect on our reputation, business, financial condition and operating results.

Privacy and data information security have become a significant issue in the United States and in many other countries where we have employees and operations and where we offer licenses or cloud subscriptions to our offerings. The regulatory framework for privacy and personal information security issues worldwide is rapidly evolving and is likely to remain uncertain for the foreseeable future. The U.S. federal and various state and foreign government bodies and agencies have adopted or are considering adopting laws and regulations limiting, or laws and regulations regarding the collection, distribution, use, disclosure, storage, and security of personal information. For example, California recently enacted the California Consumer Privacy Act, or CCPA, that will, among other things, require covered companies to provide new disclosures to California consumers, and afford such consumers new abilities to opt-out of certain sales of personal information, when it goes into effect on January 1, 2020. The CCPA recently was amended, and it is possible that it will be amended again before it goes into effect. We cannot yet predict the impact of the CCPA on our business or operations, but it may require us to modify our data processing practices and policies and to incur substantial costs and expenses in an effort to comply.

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. Laws and regulations in these jurisdictions apply broadly to the collection, use, storage, disclosure and security of data that identifies or may be used to identify or locate an individual, such as names, email addresses and, in some jurisdictions, Internet Protocol ("IP") addresses. These laws and regulations often are more restrictive than those in the United States and are rapidly evolving. For example, a new EU data protection regime, the General Data Protection Regulation ("GDPR") became effective on May 25, 2018, and we self-certified to the EU-U.S. and the Swiss-U.S. Privacy Shield Frameworks developed by the U.S. Department of Commerce and the European Commission to provide U.S. companies with a valid data transfer mechanism under EU and Swiss law to permit them to transfer personal data from the European Union or Switzerland to the United States. The EU-U.S. and Swiss-U.S. Privacy Shield Frameworks are subject to annual review. The EU-U.S. Privacy Shield Framework has faced challenges in European courts, and may be challenged, suspended or invalidated. Additionally, the United Kingdom enacted legislation in May 2018 that substantially implements the GDPR. Complying with the

GDPR or other laws, regulations, or other obligations relating to privacy, data protection, or information security may cause us to incur substantial operational costs or require us to modify our data handling practices. Non-compliance could result in proceedings against us by governmental entities or others, could result in substantial fines or other liability, and may otherwise adversely impact our business, financial condition and operating results.

Some statutory requirements, both in the United States and abroad, include obligations of companies to notify individuals of security breaches involving particular personal information, which could result from breaches experienced by us or our service providers. Even though we may have contractual protections with our service providers, a security breach could impact our reputation, harm our customer confidence, hurt our sales and expansion into new markets or cause us to lose existing customers, and could expose us to potential liability or require us to expend significant resources on data security and in responding to such breach.

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In addition to government regulation, privacy advocates and industry groups may propose new and different self-regulatory standards that may legally or contractually apply to us. We also expect that there will continue to be new proposed laws and regulations concerning privacy, data protection and information security, and we cannot yet determine the impact such future laws, regulations and standards may have on our business. New laws, amendments to or re-interpretations of existing laws and regulations, industry standards, contractual obligations and other obligations may require us to incur additional costs and restrict our business operations. Because the interpretation and application of laws and other obligations relating to privacy and data protection are still uncertain, it is possible that these laws and other obligations may be interpreted and applied in a manner that is inconsistent with our existing data management practices or the features of our offerings. If so, in addition to the possibility of fines, lawsuits and other claims, we could be required to fundamentally change our business activities and practices or modify our offerings, which could have an adverse effect on our business. We may be unable to make such changes and modifications in a commercially reasonable manner or at all, and our ability to develop new offerings and features could be limited. Any inability to adequately address privacy concerns, even if unfounded, or comply with applicable privacy or data protection 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 offerings. For example, as a service provider to our customers, we may collect and use personally identifiable information, including protected health information, which may subject us to a number of data protection, security, privacy and other government- and industry-specific requirements, including those that require companies to notify individuals of data security incidents involving certain types of personal data, such as the Health Insurance Portability and Accountability Act of 1996 ("HIPAA"). Privacy and personal information security concerns, whether valid or not valid, may inhibit market adoption of our offerings particularly in certain industries and foreign countries.

If we are unable to attract and retain leadership and key personnel, our business could be adversely affected.

We depend on the continued contributions of our leadership, senior management and other key personnel, the loss of whom could adversely affect our business. With any change in leadership, there is a risk to organizational effectiveness and employee retention as well as the potential for disruption to our business. All of our executive officers and key employees are at-will employees, which means they may terminate their employment relationship with us at any time. We do not maintain a key-person life insurance policy on any of our officers or other employees.

Our future success also depends on our ability to identify, attract and retain highly skilled technical, managerial, finance and other personnel, particularly in our sales and marketing, research and development, general and administrative, and professional service departments. We face intense competition for qualified individuals from numerous software and other technology companies.

In addition, competition for qualified personnel, particularly software engineers, is particularly intense in the San Francisco Bay Area, where our headquarters are located. We may incur significant costs to attract and retain them, and we may lose new employees to our competitors or other technology companies before we realize the benefit of our investment in recruiting and training them. As we move into new geographies, we will need to attract and recruit skilled personnel in those areas. If we are unable to attract and retain suitably qualified individuals who are capable of meeting our growing technical, operational and managerial requirements, on a timely basis or at all, our business will be adversely affected.

Volatility or lack of performance in our stock price may also affect our ability to attract and retain our key employees. Many of our senior management personnel and other key employees have become, or will soon become, vested in a substantial amount of stock, restricted stock units or stock options. Employees may be more likely to leave us if the shares they own or the shares underlying their vested restricted stock units or options have significantly appreciated in value relative to the original purchase prices of the shares or the exercise prices of the options, or, conversely, if the exercise prices of the options that they hold are significantly above the market price of our common stock. If we are unable to retain our employees, or if we need to increase our compensation expenses to retain our employees, our business, results of operations, financial condition and cash flows would be adversely affected.

We have in the past made and may in the future make acquisitions that could prove difficult to integrate and/or adversely affect our business operations and financial results.

From time to time, we may choose to expand by making acquisitions that could be material to our business, results of operations, financial condition and cash flows. Our ability as an organization to successfully acquire and integrate technologies or businesses is unproven. Acquisitions involve many risks, including the following:

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- an acquisition may negatively affect our financial results because it may require us to incur charges or assume substantial debt or other liabilities, may cause adverse tax consequences or unfavorable accounting treatment, may expose us to claims and disputes by third parties, including intellectual property claims and disputes, or may not generate sufficient financial return to offset additional costs and expenses related to the acquisition;
- potential goodwill impairment charges related to acquisitions;
- costs and potential difficulties associated with the requirement to test and assimilate the internal control processes of the acquired business;
- we may encounter difficulties or unforeseen expenditures in integrating the business, technologies, products, personnel or operations of any company that we acquire, particularly if key personnel of the acquired company decide not to work for us or if we are unable to retain key personnel;
- we may not realize the expected benefits of the acquisition;
- an acquisition may disrupt our ongoing business, divert resources, increase our expenses and distract our management;
- an acquisition may result in a delay or reduction of customer purchases for both us and the company acquired due to customer uncertainty about continuity and effectiveness of service from either company;
- the potential impact on relationships with existing customers, vendors and distributors as business partners as a result of acquiring another company or business that competes with or otherwise is incompatible with those existing relationships;
- the potential that our due diligence of the acquired company or business does not identify significant problems or liabilities, or that we underestimate the costs and effects of identified liabilities;
- exposure to litigation or other claims in connection with, or inheritance of claims or litigation risk as a result of, an acquisition, including but not limited to claims from former employees, customers or other third parties, which may differ from or be more significant than the risks our business faces;
- we may encounter difficulties in, or may be unable to, successfully sell any acquired products;
- an acquisition may involve the entry into geographic or business markets in which we have little or no prior experience or where competitors have stronger market positions;
- an acquisition may require us to comply with additional laws and regulations or result in liabilities resulting from the acquired company’s pre-acquisition failure to comply with applicable laws;
- our use of cash to pay for an acquisition would limit other potential uses for our cash;
- if we incur debt to fund such acquisition, such debt may subject us to material restrictions on our ability to conduct our business as well as financial maintenance covenants; and
- to the extent that we issue a significant amount of equity securities in connection with future acquisitions, existing stockholders may be diluted and earnings per share may decrease.

The occurrence of any of these risks could have a material adverse effect on our business operations and financial results.

If poor advice or misinformation is spread through our community website, Splunk Answers, users of our offerings may experience unsatisfactory results from using our offerings, which could adversely affect our reputation and our ability to grow our business.

We host Splunk Answers for sharing knowledge about how to perform certain functions with our offerings. Our users are increasingly turning to Splunk Answers for support in connection with their use of our offerings. We do not review or test the information that non-Splunk employees post on Splunk Answers to ensure its accuracy or efficacy in resolving technical

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issues. Therefore, we cannot ensure that all the information listed on Splunk Answers is accurate or that it will not adversely affect the performance of our offerings. Furthermore, users who post such information on Splunk Answers may not have adequate rights to the information to share it publicly, and we could be the subject of intellectual property claims based on our hosting of such information. If poor advice or misinformation is spread among users of Splunk Answers, our customers or other users of our offerings may experience unsatisfactory results from using our offerings, which could adversely affect our reputation and our ability to grow our business.

Prolonged economic uncertainties or downturns could materially adversely affect our business.

Prolonged economic downturns or uncertainty could adversely affect our business operations or financial results. Negative conditions in the general economy in either the United States or abroad, including conditions resulting from financial and credit market fluctuations, changes in economic policy, trade uncertainty and terrorist attacks on the United States, Europe, Asia Pacific or elsewhere, could cause a decrease in corporate spending on enterprise software in general and negatively affect the rate of growth of our business.

These conditions could make it extremely difficult for our customers and us to forecast and plan future business activities accurately, and they could cause our customers to reevaluate their decision to purchase our offerings, which could delay and lengthen our sales cycles or result in cancellations of planned purchases. Furthermore, during challenging economic times our customers may face issues in gaining timely access to sufficient credit, which could result in an impairment of their ability to make timely payments to us. If that were to occur, we may be required to increase our allowance for doubtful accounts, which would adversely affect our financial results.

We have a significant number of customers in the business services, energy, financial services, healthcare and pharmaceuticals, technology, manufacturing, media and entertainment, online services, retail, telecommunications and travel and transportation industries. A substantial downturn in any of these industries may cause firms to react to worsening conditions by reducing their capital expenditures in general or by specifically reducing their spending on information technology. Customers in these industries may delay or cancel information technology projects or seek to lower their costs by renegotiating vendor contracts. To the extent purchases of our offerings are perceived by customers and potential customers to be discretionary, our revenues may be disproportionately affected by delays or reductions in general information technology spending. Also, customers may choose to develop in-house software as an alternative to using our offerings. Moreover, competitors may respond to market conditions by lowering prices and attempting to lure away our customers. In addition, the increased pace of consolidation in certain industries may result in reduced overall spending on our offerings.

We cannot predict the timing, strength or duration of any economic slowdown, instability or recovery, generally or within any particular industry or geography. If the economic conditions of the general economy or industries in which we operate worsen from present levels, our business operations and financial results could be adversely affected.

We may require additional capital to support business growth, and this capital might not be available on acceptable terms, if at all.

We intend to continue to make investments to support our business growth and may require additional funds to respond to business challenges, including the need to develop new features or enhance our offerings, improve our operating infrastructure or acquire complementary businesses and technologies. Accordingly, we have engaged in, and may need to engage in the future, in equity or debt financings to secure additional funds. If we raise additional funds through future issuances of equity or convertible debt securities, our existing stockholders could suffer significant dilution, and any new equity securities we issue could have rights, preferences and privileges superior to those of holders of our common stock. If we elect to settle our conversion obligation under the Notes in shares of our common stock or a combination of cash and shares of our common stock, the issuance of such common stock may dilute the ownership interests of our stockholders and sales in the public market could adversely affect prevailing market prices. Any debt financing that we may secure in the future could involve restrictive covenants relating to our capital raising activities and other financial and operational matters, which may make it more difficult for us to obtain additional capital and to pursue business opportunities, including potential acquisitions, or otherwise reduce operational flexibility. We may not be able to obtain additional financing on terms favorable to us, if at all. If we are unable to obtain adequate financing or financing on terms satisfactory to us when we require it, our ability to continue to support our business growth and to respond to business challenges could be significantly impaired, and our business may be adversely affected.

If currency exchange rates fluctuate substantially in the future, our financial results, which are reported in U.S. dollars, could be adversely affected.

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As we continue to expand our international operations, we become more exposed to the effects of fluctuations in currency exchange rates. Although our sales contracts are denominated in U.S. dollars, and therefore our revenues are not subject to foreign currency risk, a strengthening of the U.S. dollar could increase the real cost of our offerings to our customers outside of the United States, adversely affecting our business operations and financial results. We incur expenses for employee compensation and other operating expenses at our non-U.S. locations in the local currency. Fluctuations in the exchange rates between the U.S. dollar and other currencies could result in the dollar equivalent of such expenses being higher. This could have a negative impact on our reported operating results. Although we engage in limited hedging strategies, any such strategies, such as forward contracts, options and foreign exchange swaps, related to transaction exposures that we may implement to mitigate this risk may not eliminate our exposure to foreign exchange fluctuations.

Changes in U.S. tax laws could materially impact our business, cash flow, results of operations or financial conditions.

Legislation commonly referred to as the 2017 Tax Cuts and Jobs Act, or the Act, was enacted on December 22, 2017, and significantly changes how the U.S. imposes income tax on multinational corporations. The U.S. Treasury Department has broad authority to issue regulations and interpretative guidance that may significantly impact how we will apply the law and affect our results of operations. The Act requires complex computations not previously provided for in U.S. tax law. As such, the application of accounting guidance for such items is currently uncertain. We have provided a provisional estimate of the effect of the Act in our consolidated financial statements. As additional regulatory guidance is issued by the applicable taxing authorities and accounting treatment is clarified, we may make adjustments to our provisional estimate which may materially affect our business, cash flow, results of operations or financial conditions.

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

In general, under Section 382 of the United States Internal Revenue Code of 1986, as amended, or the Code, a corporation that undergoes an ownership change is subject to limitations on its ability to utilize its pre-change net operating losses, or NOLs, to offset future taxable income. If our existing NOLs are subject to limitations arising from previous ownership changes, our ability to utilize NOLs could be limited by Section 382 of the Code. 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 either under prior regulations or other unforeseen reasons, our prior year NOLs could expire or otherwise be unavailable to offset future income tax liabilities. For these reasons, we may not be able to utilize a portion of these NOLs reflected on our balance sheet, even if we attain profitability.

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 financial results.

We do not collect sales and use, value added and similar taxes in all jurisdictions in which we have sales, based on our belief 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 financial results.

Our international operations subject us to potentially adverse tax consequences.

We generally conduct our international operations through wholly owned subsidiaries, branches and representative offices and report our taxable income in various jurisdictions worldwide based upon our business operations in those jurisdictions. We are in the process of organizing our corporate structure to more closely align with the international nature of our business activities. 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 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.

We could be subject to additional tax liabilities.

We are subject to federal, state and local taxes in the United States and numerous foreign jurisdictions. Significant judgment is required in evaluating our tax positions and our worldwide provision for taxes. During the ordinary course of

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business, there are many activities and transactions for which the ultimate tax determination is uncertain. We previously discovered that we have not complied with various tax rules and regulations in certain foreign jurisdictions. We are working to resolve these matters. In addition, our tax obligations and effective tax rates could be adversely affected by changes in the relevant tax, accounting and other laws, regulations, principles and interpretations, including those relating to income tax nexus, by our earnings being lower than anticipated in jurisdictions where we have lower statutory rates and higher than anticipated in jurisdictions where we have higher statutory rates, by changes in foreign currency exchange rates, or by changes in the valuation of our deferred tax assets and liabilities. We may be audited in various jurisdictions, and such jurisdictions may assess additional taxes against us. Although we believe our tax estimates are reasonable, the final determination of any tax audits or litigation could be materially different from our historical tax provisions and accruals, which could have a material adverse effect on our operating results or cash flows in the period or periods for which a determination is made.

Our financial results may be adversely affected by changes in accounting principles applicable to us.

Generally accepted accounting principles in the United States ("U.S. GAAP") are subject to interpretation by the Financial Accounting Standards Board ("FASB"), the SEC, and other various bodies formed to promulgate and interpret appropriate accounting principles. For example, in May 2014, the FASB issued accounting standards update No. 2014-09 (Topic 606), Revenue from Contracts with Customers, which supersedes nearly all existing revenue recognition guidance under U.S. GAAP. We adopted this new revenue standard as of February 1, 2018. Under Topic 606, more estimates, judgments and assumptions are required within the revenue recognition process than were previously required. Our reported financial position and financial results may be adversely affected if our estimates or judgments prove to be wrong, assumptions change or actual circumstances differ from those in our assumptions. We presently anticipate that this standard could create volatility in our reported revenue and operating results, which could negatively impact our stock price. The most significant impacts of the standard relate to the timing of revenue recognition for arrangements involving term licenses, deferred revenue and sales commissions. Additionally, some deferred revenue, primarily from arrangements involving term licenses, was never recognized as revenue and instead is now part of the cumulative effect adjustment within accumulated deficit. See Part I, Item 1. Financial Information - Note 1 for information regarding the effect of new accounting pronouncements on our consolidated financial statements. These or other changes in accounting principles could adversely affect our financial results. Any difficulties in implementing these pronouncements could cause us to fail to meet our financial reporting obligations, which could result in regulatory discipline and harm investors' confidence in us.

Servicing our debt requires a significant amount of cash, and we may not have sufficient cash flow from our business to pay our substantial debt.

Our ability to make scheduled payments of the principal of, to pay interest on or to refinance our indebtedness, including the Notes, depends on our future performance, which is subject to economic, financial, competitive and other factors beyond our control. Our business may not continue to generate cash flow from operations in the future sufficient to service our debt and make necessary capital expenditures. If we are unable to generate such cash flow, we may be required to adopt one or more alternatives, such as selling assets, restructuring debt or obtaining additional equity capital on terms that may be onerous or highly dilutive. Our ability to refinance our indebtedness will depend on the capital markets and our financial condition at such time. We may not be able to engage in any of these activities or engage in these activities on desirable terms, which could result in a default on our debt obligations.

Conversion of the Notes may dilute the ownership interest of our stockholders or may otherwise depress the price of our common stock.

The conversion of some or all of the notes may dilute the ownership interests of our stockholders. Upon conversion of the notes, we have the option to pay or deliver, as the case may be, cash, shares of our common stock, or a combination of cash and shares of our common stock. If we elect to settle our conversion obligation in shares of our common stock or a combination of cash and shares of our common stock, any sales in the public market of our common stock issuable upon such conversion could adversely affect prevailing market prices of our common stock. In addition, the existence of the notes may encourage short selling by market participants because the conversion of the notes could be used to satisfy short positions, or anticipated conversion of the notes into shares of our common stock could depress the price of our common stock.

The conditional conversion feature of the Notes, if triggered, may adversely affect our financial condition and operating results.

In the event the conditional conversion feature of a series of Notes is triggered, holders of such Notes will be entitled to convert their Notes at any time during specified periods at their option. If one or more holders elect to convert their Notes,

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unless we elect to satisfy our conversion obligation by delivering solely shares of our common stock (other than paying cash in lieu of delivering any fractional share), we would be required to settle a portion or all of our conversion obligation through the payment of cash, which could adversely affect our liquidity. In addition, even if holders do not elect to convert their Notes, we could be required under applicable accounting rules to reclassify all or a portion of the outstanding principal of the relevant series of Notes as a current rather than long-term liability, which would result in a material reduction of our net working capital.

The accounting method for convertible debt securities that may be settled in cash, such as the notes, could have a material effect on our reported financial results.

In May 2008, the Financial Accounting Standards Board, or FASB, issued FASB Staff Position No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash Upon Conversion (Including Partial Cash Settlement), which has subsequently been codified as Accounting Standards Codification 470-20, Debt with Conversion and Other Options, or ASC 470-20.

Under ASC 470-20, an entity must separately account for the liability and equity components of the convertible debt instruments (such as the notes) that may be settled entirely or partially in cash upon conversion in a manner that reflects the issuer's economic interest cost. The effect of ASC 470-20 on the accounting for the notes is that the equity component is required to be included in the additional paid-in capital section of stockholders' equity on our consolidated balance sheet at issuance, and the value of the equity component would be treated as original issue discount for purposes of accounting for the debt component of the notes. As a result, we will be required to record a greater amount of non-cash interest expense in current periods presented as a result of the amortization of the discounted carrying value of the notes to their respective face amounts over their respective terms. We will report larger net losses or lower net income in our financial results because ASC 470-20 will require interest to include both the current period's amortization of the debt discount and the instrument's non-convertible coupon interest rate, which could adversely affect our reported or future financial results, the trading price of our common stock and the trading price of the notes.

In addition, under certain circumstances, convertible debt instruments (such as the notes) that may be settled entirely or partly in cash are currently accounted for utilizing the treasury stock method, the effect of which is that the shares issuable upon conversion of a series of notes are not included in the calculation of diluted earnings per share except to the extent that the conversion value of such series of notes exceeds their principal amount. Under the treasury stock method, for diluted earnings per share purposes, the transaction is accounted for as if the number of shares of common stock that would be necessary to settle such excess, if we elected to settle such excess in shares, are issued. We cannot be sure that the accounting standards in the future will continue to permit the use of the treasury stock method. If we are unable or otherwise elect not to use the treasury stock method in accounting for the shares issuable upon conversion of the notes, then the "if converted" method of accounting would be applied and accordingly, the full number of shares that could be issued would be included in the calculation of diluted earnings per share, which would adversely affect our diluted earnings per share.

The Capped Calls may affect the value of our common stock.

In connection with the pricing of the Notes, we entered into the Capped Calls relating to each series of Notes with one or more of the option counterparties. The Capped Calls relating to the 2023 Notes cover, subject to customary adjustments, the number of shares of our common stock that will initially underlie the 2023 Notes, and the Capped Calls relating to the 2025 Notes cover, subject to customary adjustments, the number of shares of our common stock that will initially underlie the 2025 Notes. The Capped Calls are expected generally to offset the potential dilution to our common stock as a result of any conversion of the relevant series of Notes. If the initial purchasers exercise their option to purchase additional Notes, we expect to enter into additional Capped Calls with the option counterparties with respect to the relevant series of Notes as to which the option was exercised.

In connection with establishing their initial hedges of the Capped Calls, the option counterparties or their respective affiliates may purchase shares of our common stock and/or enter into various derivative transactions with respect to our common stock concurrently with or shortly after the pricing of the Notes, including with certain investors in the Notes. This activity could increase (or reduce the size of any decrease in) the market price of our common stock at that time.

In addition, the option counterparties or their respective affiliates may modify their hedge positions by entering into or unwinding various derivatives with respect to our common stock and/or purchasing or selling our common stock or other securities of ours in secondary market transactions following the pricing of the Notes and prior to the maturity of the Notes (and are likely to do so on each exercise date for the Capped Calls, which are expected to occur during each 30 trading day period beginning on the 31st scheduled trading day prior to the maturity date of each series of Notes, or following any termination of any portion of the Capped Calls in connection with any repurchase, redemption or early conversion of the Notes). This activity could also cause or prevent an increase or a decrease in the market price of our common stock.

In addition, if any such Capped Calls fail to become effective, the option counterparties or their respective affiliates may unwind their hedge positions with respect to our common stock, which could adversely affect the price of our common stock.

We do not make any representation or prediction as to the direction or magnitude of any potential effect that the transactions described above may have on the price of the shares of our common stock. In addition, we do not make any representation that the counterparties will engage in these transactions or that these transactions, once commenced, will not be discontinued without notice.

We are subject to counterparty risk with respect to the Capped Calls.

The option counterparties to the Capped Calls we have entered into are financial institutions, and we will be subject to the risk that one or more of the option counterparties may default or otherwise fail to perform, or may exercise certain rights to terminate, their obligations under the Capped Calls. Our exposure to the credit risk of the option counterparties will not be secured by any collateral.

If an option counterparty to one or more Capped Calls becomes subject to insolvency proceedings, we will become an unsecured creditor in those proceedings with a claim equal to our exposure at the time under such transaction. Our exposure will depend on many factors but, generally, our exposure will increase if the market price or the volatility of our common stock increases. In addition, upon a default or other failure to perform, or a termination of obligations, by an option counterparty, we may suffer more dilution than we currently anticipate with respect to our common stock. We can provide no assurances as to the financial stability or viability of the option counterparties.

Our stock price has been volatile, may continue to be volatile and may decline regardless of our financial performance.

The trading prices of the securities of technology companies have been highly volatile. The market price of our common stock has fluctuated significantly and may continue to fluctuate significantly in response to numerous factors, many of which are beyond our control, including:

- actual or anticipated fluctuations in our financial results;
- the financial projections we provide to the public, any changes in these projections or our failure to meet or exceed these projections;
- failure of securities analysts to initiate or maintain coverage of our company, changes in financial estimates 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;
- 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 certain categories of companies or the overall stock market, including as a result of trends in the global economy;
- any major change in our board of directors or management;
- lawsuits threatened or filed against us;
- cybersecurity attacks or incidents; and
- other events or factors, including those resulting from war, incidents of terrorism or responses to these events.

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In addition, the stock markets, and in particular the market on which our common stock is listed, 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 financial 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 our business and adversely affect our business, results of operations, financial condition and cash flows.

If securities or industry analysts publish negative reports about our business, or cease coverage of our company, our share 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, our market and our competitors. We do not have any control over these analysts. If one or more of the analysts who cover us downgrade our shares or change their opinion of our shares, our share price would likely decline. If one or more of these analysts cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which could cause our share price or trading volume to decline.

The requirements of being a public company and a growing and increasingly complex organization 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 Securities Exchange Act of 1934, or the Exchange Act, the Sarbanes-Oxley Act, the Dodd-Frank Act, the listing requirements of The NASDAQ Stock Market and other applicable securities rules and regulations. Compliance with these rules and regulations has increased our legal and financial compliance costs, made some activities more difficult, time-consuming or costly and increased and will continue to increase demand on our systems and resources. 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. As a result, 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 comply with these requirements, we may need to hire more employees in the future or engage outside consultants, which will increase our costs and expenses.

In addition, changing laws, regulations, standards and practices 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, standards and practices 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 regulatory and governing bodies provide new guidance or as market practices develop. This could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We will continue to invest resources to comply with evolving laws, regulations and standards and keeping abreast of current practices, and this investment may result in increased general and administrative expenses and a diversion of management's time and attention from revenue-generating activities to compliance and corporate governance 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.

Our business has become more visible and complex as we grow as an organization, which we believe may result in threatened or actual litigation, including by competitors and other third parties. We are also from time to time involved in various litigation matters and claims, including regulatory proceedings, administrative proceedings, governmental investigations, and contract disputes, as they relate to our products, services, business and operations. We may also face employment-related litigation, including claims under local, state, federal and foreign labor laws. If such claims are successful, our business operations and financial 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 operations and financial results. From time to time, public companies are subject to campaigns by investors seeking to increase short-term stockholder value through actions such as financial restructuring, increased debt, special dividends, stock repurchases, management changes or sales of assets or the entire company. If stockholders attempt to effect such changes or acquire control over us, responding to such actions would be costly, time-consuming and disruptive, which could adversely affect our results of operations, financial results and the value of our common stock. These factors could also make it more difficult for us to attract and retain qualified employees, executive officers and members of our board of directors.

We are obligated to develop and maintain proper and effective internal control over financial reporting. These internal controls may not be determined to be effective, which may adversely affect investor confidence in our company and, as a result, the value of our common stock.

We are required, pursuant to Section 404 of the Sarbanes-Oxley Act, to furnish a report by management on, among other things, the effectiveness of our internal control over financial reporting. This assessment includes disclosure of any material weaknesses identified by our management in our internal control over financial reporting. We are also required to have our independent registered public accounting firm issue an opinion on the effectiveness of our internal control over financial reporting on an annual basis. During the evaluation and testing process, if we identify one or more material weaknesses in our internal control over financial reporting, we will be unable to assert that our internal controls are effective.

If we are unable to assert that our internal control over financial reporting is effective, or if our independent registered public accounting firm is unable to express an opinion on the effectiveness of our internal control over financial reporting, we could lose investor confidence in the accuracy and completeness of our financial reports, which would cause the price of our common stock to decline, and we may be subject to investigation or sanctions by the SEC.

We do not intend to pay dividends for the foreseeable future.

We have never declared or paid any cash dividends on our common stock and do not intend to pay any cash dividends in the foreseeable future. We anticipate that we will retain all of our future earnings for use in the development of our business and for general corporate purposes. Any determination to pay dividends in the future will be at the discretion of our board of directors. Accordingly, price appreciation of our common stock, which may never occur, may be the only way our stockholders realize any future gains on their investments.

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;

- 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 Chairman 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
- require the approval of our board of directors or the holders of a supermajority of our outstanding shares of capital stock to amend our bylaws and certain provisions of our certificate of incorporation.

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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.

Item 6. Exhibits

The exhibits listed in the accompanying Exhibit Index are filed or incorporated by reference as part of this Quarterly Report.

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EXHIBIT INDEX

Exhibit Number	Description
4.1	Indenture, dated as of September 21, 2018, by and between the Registrant and U.S. Bank National Association, as Trustee (incorporated by reference to Exhibit 4.1 filed with the Registrant's Current Report on Form 8-K filed on September 21, 2018).
4.2	Form of Global Note, representing Splunk Inc.'s 0.50% Convertible Senior Notes due 2023 (incorporated by reference to Exhibit A to the Indenture filed as Exhibit 4.1 filed with the Registrant's Current Report on Form 8-K filed on September 21, 2018).
4.3	Indenture, dated as of September 21, 2018, by and between the Registrant and U.S. Bank National Association, as Trustee (incorporated by reference to Exhibit 4.3 filed with the Registrant's Current Report on Form 8-K filed on September 21, 2018).
4.4	Form of Global Note, representing Splunk Inc.'s 0.50% Convertible Senior Notes due 2023 (incorporated by reference to Exhibit A to the Indenture filed as Exhibit 4.3 filed with the Registrant's Current Report on Form 8-K filed on September 21, 2018).
10.1#	Amended and Restated Employment Offer Letter between the Registrant and Scott Morgan, dated as of October 30, 2018.
10.2	Form of Confirmation for Capped Call Transactions (incorporated by reference to Exhibit 10.1 filed with the Registrant's Current Report on Form 8-K filed on September 21, 2018).
31.1	Certification of Principal Executive Officer Required Under Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.2	Certification of Principal Financial Officer Required Under Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended.
32.1	Certification of Principal Executive Officer and Principal Financial Officer Required Under Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended, and 18 U.S.C. §1350.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Schema Linkbase Document
101.CAL	XBRL Taxonomy Calculation Linkbase Document
101.DEF	XBRL Taxonomy Definition Linkbase Document
101.LAB	XBRL Taxonomy Labels Linkbase Document
101.PRE	XBRL Taxonomy Presentation Linkbase Document

# Indicates management contract or compensatory plan.

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SIGNATURES

Pursuant to the requirements 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.

Date: December 7, 2018

SPLUNK INC.

By: /s/ David F. Conte
David F. Conte
Senior Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)