

BARRACUDA NETWORKS INC

Form 10-Q

October 10, 2017

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended August 31, 2017

or

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

For the transition period from _____ to _____
Commission File Number 001-36162

BARRACUDA NETWORKS, INC.
(Exact name of registrant as specified in its charter)

Delaware 83-0380411
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

3175 S. Winchester Blvd.
Campbell, California 95008
(408) 342-5400

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

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 No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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 Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Emerging growth company

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.

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

The number of shares outstanding of the registrant's common stock outstanding as of September 29, 2017 was 53,281,244.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements contained in this Quarterly Report on Form 10-Q other than statements of historical fact, including statements regarding our future results of operations and financial position, our business strategy and plans, and our objectives for future operations, are forward-looking statements. The words "believe," "may," "will," "potentially," "estimate," "continue," "anticipate," "intend," "could," "would," "project," "plan," "expect" and the negative and plural forms of these words and similar expressions are intended to identify forward-looking statements. These forward-looking statements include, but are not limited to, statements concerning the following:

- our future financial performance, including our expectations regarding our revenue, cost of revenue, gross profit or gross margin, operating expenses, including changes in research and development, sales and marketing and general and administrative expenses, and our ability to achieve and maintain future profitability;
- our business plan and our ability to effectively manage our growth and associated investments;
- anticipated trends, growth rates and challenges in our business and in the markets in which we operate;
- market acceptance of recently introduced security and data protection solutions;
- beliefs about and objectives for future operations;
- our ability to increase sales of our solutions and renewals of our subscriptions;
- our ability to attract and retain customers;
- our ability to cross-sell to our existing customers;
- maintaining and expanding our customer base and our relationships with our channel partners;
- our ability to timely and effectively scale and adapt our existing solutions;
- our ability to develop new solutions and bring them to market in a timely manner;
- our ability to maintain, protect and enhance our brand and intellectual property;
- our ability to continue to expand internationally;
- the effects of increased competition in our markets and our ability to compete effectively;
- sufficiency of cash to meet cash needs for at least the next 12 months;
- future acquisitions or investments;
- our ability to stay in compliance with laws and regulations that currently apply or become applicable to our business both in the United States and internationally;
- economic and industry trends or trend analysis;
- the attraction and retention of qualified employees and key personnel;
- the estimates and estimate methodologies used in preparing our condensed consolidated financial statements;
- the impact of our stock repurchase program; and
- the future trading prices of our common stock.

We have based these forward-looking statements largely on our current expectations and projections about future events and trends that we believe may affect our financial condition, results of operations, business strategy, short-term and long-term business operations and objectives and financial needs; however, these forward-looking statements are subject to a number of risks, uncertainties and assumptions, including those described in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended February 28, 2017. Moreover, we operate in a very competitive and rapidly changing environment and new risks emerge from time to time. It is not possible for us to predict all risks, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements we may make. In light of these risks, uncertainties and assumptions, the future events and trends discussed in this Quarterly Report on Form 10-Q may not occur and actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements.

We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements, except as required by law. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements. You should read this Quarterly Report on Form 10-Q and the documents that we reference in this Quarterly Report on Form 10-Q and have filed with the SEC as exhibits to this Quarterly

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Report on Form 10-Q with the understanding that our actual future results, levels of activity, performance and events and circumstances may be materially different from what we expect.

Unless expressly indicated or the context requires otherwise, the terms "Barracuda," "company," "we," "us," and "our" in this document refer to Barracuda Networks, Inc., a Delaware corporation, and, where appropriate, its wholly owned subsidiaries. The term "Barracuda" may also refer to our products, regardless of the manner in which they are accessed.

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

BARRACUDA NETWORKS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

(unaudited)

	As of August 31, 2017	As of February 28, 2017
Assets		
Current assets:		
Cash and cash equivalents	\$ 125,585	\$ 120,194
Marketable securities	80,991	79,915
Accounts receivable, net of allowance for doubtful accounts of \$3,217 and \$2,857 as of August 31, 2017 and February 28, 2017, respectively	40,899	40,560
Inventories, net	6,520	5,847
Prepaid income taxes	3,107	11,050
Deferred costs	34,206	32,598
Other current assets	7,366	5,245
Total current assets	298,674	295,409
Property and equipment, net	32,043	29,979
Deferred costs, non-current	30,246	27,285
Deferred income taxes, non-current	1,023	1,554
Other non-current assets	15,320	8,607
Intangible assets, net	28,692	32,145
Goodwill	70,653	69,795
Total assets	\$ 476,651	\$ 464,774
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 7,710	\$ 11,439
Accrued payroll and related benefits	12,825	13,593
Other accrued liabilities	10,773	12,942
Deferred revenue	245,517	239,796
Note payable	—	4,115
Total current liabilities	276,825	281,885
Long-term liabilities:		
Deferred revenue, non-current	168,148	167,286
Deferred income taxes, non-current	3,073	2,803
Other long-term liabilities	6,776	6,377
Commitments and contingencies (Note 8)		
Stockholders' equity:		
Preferred stock, \$0.001 par value; 20,000,000 shares authorized; zero shares issued and outstanding as of August 31, 2017 and February 28, 2017, respectively	—	—
Common stock, \$0.001 par value; 1,000,000,000 shares authorized; 53,153,432 and 52,897,128 shares issued and outstanding as of August 31, 2017 and February 28, 2017, respectively	53	53
Additional paid-in capital	384,395	370,745
Accumulated other comprehensive loss	(3,076)	(5,226)
Accumulated deficit	(359,543)	(359,149)

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Total stockholders' equity	21,829	6,423
Total liabilities and stockholders' equity	\$476,651	\$ 464,774
See accompanying notes.		

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BARRACUDA NETWORKS, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF INCOME
 (in thousands, except per share data)
 (unaudited)

	Three Months Ended August 31,		Six Months Ended August 31,	
	2017	2016	2017	2016
Revenue:				
Appliance	\$18,347	\$21,034	\$38,612	\$42,367
Subscription	75,978	66,896	149,892	132,217
Total revenue	94,325	87,930	188,504	174,584
Cost of revenue	25,198	20,240	48,846	40,481
Gross profit	69,127	67,690	139,658	134,103
Operating expenses:				
Research and development	19,440	18,446	38,796	37,653
Sales and marketing	38,561	32,144	74,781	63,474
General and administrative	10,338	10,969	21,282	21,741
Total operating expenses	68,339	61,559	134,859	122,868
Income from operations	788	6,131	4,799	11,235
Other income, net	1,124	1,515	2,308	2,505
Income before income taxes	1,912	7,646	7,107	13,740
Provision for income taxes	(358)	(5,209)	(2,881)	(8,519)
Net income (Note 9)	\$1,554	\$2,437	\$4,226	\$5,221
Net income per share:				
Basic	\$0.03	\$0.05	\$0.08	\$0.10
Diluted	\$0.03	\$0.05	\$0.08	\$0.10
Weighted-average shares used to compute net income per share:				
Basic	53,040	52,265	52,958	52,275
Diluted	54,609	53,321	54,470	53,088
See accompanying notes.				

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BARRACUDA NETWORKS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(unaudited)

	Three Months Ended August 31, 2017		Six Months Ended August 31, 2016	
Net income	\$1,554	\$2,437	\$4,226	\$5,221
Other comprehensive income, net of tax:				
Change in net foreign currency translation adjustment	1,090	(708)	1,991	(374)
Available-for-sale investments:				
Change in net unrealized gains (losses) (net of tax effect of \$0 in all periods)	68	(240)	149	370
Less: reclassification adjustment for net gains (losses) included in net income (net of tax effect of \$(4), \$247, \$(6) and \$394)	5	(459)	10	(732)
Net change	73	(699)	159	(362)
Other comprehensive income (loss)	1,163	(1,407)	2,150	(736)
Comprehensive income	\$2,717	\$1,030	\$6,376	\$4,485
See accompanying notes.				

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

	Six Months Ended August 31,	
	2017	2016
Operating activities		
Net income	\$4,226	\$5,221
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and impairment expense	8,545	8,467
Stock-based compensation expense	17,011	15,833
Excess tax benefits from equity compensation plans	—	(791)
Deferred income taxes	804	474
Other	(261)	(728)
Changes in operating assets and liabilities:		
Accounts receivable, net	(318)	2,732
Inventories, net	(744)	(83)
Income taxes, net	8,122	3,598
Deferred costs	(4,738)	340
Other assets	(5,027)	(597)
Accounts payable	(3,043)	(6,679)
Accrued payroll and related benefits	(641)	1,126
Other liabilities	(481)	(762)
Deferred revenue	7,755	4,456
Net cash provided by operating activities	31,210	32,607
Investing activities		
Purchases of marketable securities	(21,769)	(21,777)
Proceeds from the sale of marketable securities	12,250	10,294
Proceeds from the maturity of marketable securities	8,342	8,018
Purchases of non-marketable investments	(4,000)	(636)
Purchases of property and equipment	(7,816)	(2,969)
Purchases of intangible assets	—	(1,000)
Business combinations, net of cash acquired	(506)	(243)
Payments for the sale of net liabilities	(800)	—
Net cash used in investing activities	(14,299)	(8,313)
Financing activities		
Proceeds from issuance of common stock	3,009	4,869
Taxes paid related to net share settlement of equity awards	(4,474)	(2,544)
Excess tax benefits from equity compensation plans	—	791
Employee loans extended, net of repayment	31	(2)
Repayment of note payable	(4,115)	(133)
Repurchases of common stock	(6,546)	(7,241)
Payments of acquisition-related liabilities	(743)	—
Net cash used in financing activities	(12,838)	(4,260)
Effect of exchange rate changes	1,335	463
Net increase in cash, cash equivalents and restricted cash	5,408	20,497
Cash, cash equivalents and restricted cash at beginning of period	120,837	119,333
Cash, cash equivalents and restricted cash at end of period	\$126,245	\$139,830

See accompanying notes.

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BARRACUDA NETWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Overview and Basis of Presentation

Nature of Operations

Barracuda Networks, Inc., also referred to in this report as "we," "our," "us," "Barracuda" or "the Company," is headquartered in Campbell, California, and designs and delivers powerful yet easy-to-use security and data protection solutions. We offer cloud-enabled solutions that help our customers address security threats, improve network performance and protect and store their data. Our solutions are designed to simplify IT operations for our customers, allowing them to enhance their return on technology investments.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles in the United States ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. We evaluate our estimates on an ongoing basis, including those related to the fair values of stock-based awards, taxes and contingent liabilities, among others. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results could differ from those estimates and such differences could be material to our condensed consolidated financial position and results of operations.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with GAAP, and follow the requirements of the U.S. Securities and Exchange Commission (the "SEC") for interim reporting. As permitted under those rules, certain footnotes or other financial information that are normally required by GAAP are condensed or omitted. In management's opinion, the unaudited condensed financial statements have been prepared on the same basis as the audited financial statements and include all adjustments, which include only normal recurring adjustments, necessary for the fair presentation of our financial information. The results for the three and six months ended August 31, 2017 are not necessarily indicative of the results expected for the full fiscal year. The condensed consolidated balance sheet as of February 28, 2017 has been derived from audited financial statements at that date but does not include all of the information required by GAAP.

The accompanying unaudited condensed consolidated financial statements include the accounts of Barracuda Networks, Inc. and our wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

The accompanying unaudited condensed consolidated financial statements and related financial information should be read in conjunction with the audited financial statements and related footnotes included in our most recent Annual Report on Form 10-K. There have been no material changes in our significant accounting policies from those that were disclosed in our Annual Report on Form 10-K for the fiscal year ended February 28, 2017.

Foreign Currency

For those subsidiaries whose functional currency is not the U.S. dollar, assets and liabilities are translated into U.S. dollar equivalents at the exchange rate in effect on the balance sheet date and revenues and expenses are translated into U.S. dollars using the average exchange rate over the period. Resulting currency translation adjustments are recorded in accumulated other comprehensive loss in our condensed consolidated balance sheets. We recorded net gains resulting from foreign exchange transactions of \$0.9 million and 1.9 million for the three and six months ended August 31, 2017, respectively, and \$0.9 million and \$1.4 million for the three and six months ended August 31, 2016, respectively, which were reflected as a component of other income, net in our condensed consolidated statements of income.

We have foreign subsidiaries that operate and sell our products in various markets around the world. As a result, we are exposed to foreign exchange risks. We utilize foreign exchange forward contracts to manage foreign currency risk associated with foreign currency denominated monetary assets and liabilities, primarily trade receivables, and to

reduce the volatility of earnings and cash flows related to foreign currency transactions. The fair values of our contracts as of August 31, 2017 and

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February 28, 2017 were not significant. The change in the fair value of these foreign currency forward contracts is recorded as gains (losses) in other income, net in our condensed consolidated statements of income.

Recently Adopted Accounting Pronouncements

On March 1, 2017, we adopted Accounting Standards Update No. 2016-09 ("ASU 2016-09"), which simplifies several aspects of employee share-based payment accounting. The impact of the adoption on our condensed consolidated financial statements was as follows:

Forfeitures: Under the new standard, we can make an accounting policy election to either estimate the number of share-based awards that are expected to vest or account for forfeitures when they occur. We elected to account for forfeitures when they occur and adopted this change on a modified retrospective basis. As a result, we recorded the cumulative effect of the change as a \$0.4 million increase to the March 1, 2017 opening accumulated deficit balance on our condensed consolidated balance sheets.

Income tax accounting: The standard eliminates additional paid-in-capital ("APIC") pools and requires excess tax benefits and tax deficiencies on share-based awards to be recognized in the statement of income prospectively when share-based awards vest or are settled. The standard also requires excess tax benefits to be recognized regardless of whether the benefit reduces taxes payable. We adopted the guidance related to the timing of previously unrecognized excess tax benefits, which resulted in no impact to the March 1, 2017 opening accumulated deficit balance on our condensed consolidated balance sheets.

Net income per share: Because excess tax benefits are no longer recognized in APIC, the assumed proceeds from applying the treasury stock method when calculating dilutive shares was amended to exclude the amount of excess tax benefits that would be recognized upon exercise or vesting of such awards. As a result, this reduces the assumed shares to be repurchased under the treasury stock method, thereby increasing the amount of dilutive shares used to compute earnings per share. We adopted the guidance related to the exclusion of excess tax benefits in calculating net income per share on a prospective basis, with an insignificant impact.

Cash flow presentation of excess tax benefits: Prior to the new standard, we were required to present excess tax benefits on share-based awards as a cash inflow from financing activities with a corresponding cash outflow from operating activities. The new standard required that these excess tax benefits be classified as an operating activity. We adopted the guidance related to the presentation of excess tax benefits in our condensed consolidated statements of cash flows on a prospective basis with an insignificant impact, while the prior period presented has not been adjusted. In January 2017, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update No. 2017-04 ("ASU 2017-04"), which eliminates Step 2 from the goodwill impairment test. Under ASU 2017-04, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. Additionally, an entity should consider income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit when measuring the goodwill impairment loss, if applicable. ASU 2017-04 is effective for annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. We early adopted ASU 2017-04 for impairment tests to be performed on testing dates after January 1, 2017, which did not impact our condensed consolidated financial statements.

In November 2016, the FASB issued Accounting Standards Update No. 2016-18 ("ASU 2016-18"), which requires the statement of cash flows to explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. ASU 2016-18 is effective for fiscal years beginning after December 15, 2017. We early adopted ASU 2016-18 retrospectively, effective March 1, 2017.

Net cash flows for the six months ended August 31, 2016 did not significantly change as a result of including restricted cash with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on our condensed consolidated statements of cash flows.

Recent Accounting Pronouncements

In May 2017, the FASB issued Accounting Standards Update No. 2017-09 ("ASU 2017-09"), which provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. ASU 2017-09 is effective for fiscal years beginning after December 15, 2017

and interim periods within those fiscal years, and early adoption is permitted, including in an interim period. ASU 2017-09 is to be applied on a

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prospective basis to an award modified on or after the adoption date. We do not intend to early adopt ASU 2017-09 and do not expect the adoption of ASU 2017-09 to have a material impact on our condensed consolidated financial statements.

In March 2017, the FASB issued Accounting Standards Update No. 2017-08 ("ASU 2017-08"), which shortens the amortization period for certain callable debt securities held at a premium and requires the premium to be amortized to the earliest call date. ASU 2017-08 is effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years, and early adoption is permitted, including in an interim period. If early adopted in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. ASU 2017-08 is to be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. We are currently evaluating the timing of adoption and do not expect the adoption of ASU 2017-08 to have a material impact on our condensed consolidated financial statements.

In January 2017, the FASB issued Accounting Standards Update No. 2017-01 ("ASU 2017-01"), which clarifies the definition of a business, with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. ASU 2017-01 is effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years, and early adoption is permitted for transactions which occur before the issuance or effective date of the amendments, only when the transaction has not been reported in the financial statements that have been issued or made available for issuance. ASU 2017-01 is to be applied on a prospective basis. We do not intend to early adopt ASU 2017-01 and do not expect the adoption of ASU 2017-01 to have a material impact on our condensed consolidated financial statements.

In August 2016, the FASB issued Accounting Standards Update No. 2016-15 ("ASU 2016-15") which addresses eight cash flow classification issues. ASU 2016-15 is effective for fiscal years beginning after December 15, 2017 and interim periods within those fiscal years, and early adoption is permitted, including in an interim period. If early adopted in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. Early adoption requires the adoption of all the amendments in the same period. ASU 2016-15 is to be applied through a retrospective transition method to each period presented. If it is impracticable to apply retrospectively for some of the issues, the amendments for those issues would be applied prospectively as of the earliest date practicable. We do not intend to early adopt ASU 2016-15 and do not expect the adoption of ASU 2016-15 to have a material impact on our condensed consolidated statements of cash flows.

In June 2016, the FASB issued Accounting Standards Update No. 2016-13 ("ASU 2016-13") which requires measurement and recognition of expected credit losses for financial assets held. ASU 2016-13 is effective for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years, and early adoption is permitted as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. ASU 2016-13 is to be applied through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective. We are currently evaluating the timing and the impact of adopting ASU 2016-13 on our condensed consolidated financial statements.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02 ("Topic 842") to amend lease accounting requirements and requires entities to generally recognize on the balance sheet operating and financing lease liabilities and corresponding right-of-use assets. Topic 842 will require significant additional disclosures about the amount, timing and uncertainty of cash flows from leases. Topic 842 is effective for fiscal years beginning after December 15, 2018 and interim periods within those years, and early adoption is permitted. Topic 842 is to be applied using a modified retrospective approach and includes a number of optional practical expedients that entities may elect to apply. We are currently evaluating the timing and the impact of adopting Topic 842 on our condensed consolidated financial statements and expect that most of our operating lease commitments will be subject to Topic 842 and recognized as operating lease liabilities and right-of-use assets upon the adoption.

In January 2016, the FASB issued Accounting Standards Update No. 2016-01 ("ASU 2016-01") to enhance the reporting model for financial instruments by amending certain aspects of recognition, measurement, presentation and disclosure of financial instruments. ASU 2016-01 is effective for fiscal years beginning after December 15, 2017 and interim periods within those years. Early application to financial statements of fiscal years or interim periods that have

not yet been issued is permitted by presenting separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk if we elected to measure the liability at fair value in accordance with the fair value option for financial instruments, otherwise, early adoption is not permitted. ASU 2016-01 is to be applied with a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The amendments related to equity securities without readily determinable fair values (including disclosure requirements) should be applied prospectively

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to equity investments that exist as of the date of adoption. We are currently evaluating the impact of adopting ASU 2016-01 on our condensed consolidated financial statements.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09 ("Topic 606") which completed the joint effort by the FASB and the International Accounting Standards Board to clarify the principles for recognizing revenue and improving financial reporting. Topic 606 also provides guidance on the recognition of costs related to obtaining and fulfilling customer contracts. The FASB issued subsequent amendments to the initial guidance collectively under Topic 606. Topic 606 supersedes nearly all existing revenue recognition guidance under GAAP. The core principle of Topic 606 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. Topic 606 defines a five-step process to achieve this core principle, and more judgment and estimates may be required under the Topic 606 revenue recognition process than are required under existing GAAP, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation, among others.

Topic 606 is required to be effective for us on March 1, 2018. Topic 606 allows for either full retrospective adoption applied to all periods presented or modified adoption with the cumulative effect of initially applying Topic 606 recognized at the date of initial application. We are currently considering adopting using the full retrospective approach; however, our final decision will depend on a number of factors such as the significance of the impact of the new standard on our financial results, system readiness and our ability to accumulate and analyze the information necessary to assess the impact on prior period financial statements, as necessary.

Currently, we are in the process of reviewing our historical contracts and evaluating the impact of Topic 606 on our accounting policies, processes and system requirements, and have assigned internal resources and engaged third-party service providers to assist in our evaluation. Furthermore, we will continue to make investments in systems to enable timely and accurate reporting under the new standard. While we continue to assess all potential impacts under the new standard, there is the potential for significant changes to the pattern of revenue recognition for our arrangements resulting from, for example, the identification of performance obligations, inclusion of variable consideration in the transaction price, allocation of the transaction price based on relative standalone selling prices, timing of recognition, accounting for contract acquisition costs, among other areas, as well as the related financial statement disclosures.

With respect to contract acquisition costs, we preliminarily believe that we will capitalize additional costs of obtaining the contract, including additional sales commissions, as the new cost guidance, as interpreted by the FASB Transition Resource Group for Revenue Recognition, requires the capitalization of all incremental costs that we incur to obtain a contract with a customer that we would not have incurred if the contract had not been obtained, provided we expect to recover the costs. Under our current accounting policy, we would only capitalize such costs if they are both incremental and directly related to acquiring the customer.

As we are in the initial stages of our evaluation of the impact of the new standard and the impact on our accounting policies across our multiple solutions, we do not know or cannot reasonably estimate quantitative information related to the impact of Topic 606 on our consolidated financial statements, including the effect on our operating results and our accounting for deferred commission balances, at this time.

2. Balance Sheet Information

Cash, Cash Equivalents and Restricted Cash

The following table summarizes our cash, cash equivalents and restricted cash by category (in thousands):

	As of August 31, 2017	As of February 28, 2017
Cash and cash equivalents:		
Cash	\$ 109,582	\$ 103,726
Money market funds	16,003	16,468
Other non-current assets:		
Restricted cash	660	643
	\$ 126,245	\$ 120,837

Restricted cash is primarily related to customs obligations and letters of credit associated with our leases.
Marketable Securities

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The following tables summarize our marketable securities by category (in thousands):

	As of August 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Asset-backed securities	\$9,472	\$ 9	\$ (13)	\$ 9,468
Corporate debt securities	43,768	22	(94)	43,696
Foreign government bonds	650	1	—	651
Mortgage-backed securities	3,404	2	(7)	3,399
U.S. government agency securities	13,679	6	(38)	13,647
U.S. government notes	10,136	6	(12)	10,130
	\$81,109	\$ 46	\$ (164)	\$ 80,991

	As of February 28, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Asset-backed securities	\$9,597	\$ 6	\$ (28)	\$ 9,575
Corporate debt securities	41,822	11	(140)	41,693
Foreign government bonds	650	—	(1)	649
Mortgage-backed securities	3,324	—	(22)	3,302
U.S. government agency securities	12,707	1	(77)	12,631
U.S. government notes	12,092	2	(29)	12,065
	\$80,192	\$ 20	\$ (297)	\$ 79,915

We use the specific-identification method to determine any realized gains or losses from the sale of our marketable securities classified as available-for-sale. For the three and six months ended August 31, 2017, realized gross gains and losses were insignificant. For the three and six months ended August 31, 2016, we realized gross gains of \$0.7 million and \$1.1 million, respectively, and an insignificant amount of gross losses. We reflect these gains and losses as a component of other income, net in our condensed consolidated statements of income.

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The following tables present gross unrealized losses and fair values for those marketable securities that were in an unrealized loss position aggregated by investment category and the length of time that individual securities have been in a continuous loss position (in thousands):

	As of August 31, 2017					
	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Asset-backed securities	\$5,809	\$ (13)	\$ —	\$ —	\$5,809	\$ (13)
Corporate debt securities	30,297	(88)	3,000	(7)	33,297	(95)
Mortgage-backed securities	1,914	(6)	131	—	2,045	(6)
U.S. government agency securities	7,817	(22)	4,008	(16)	11,825	(38)
U.S. government notes	4,493	(9)	398	(3)	4,891	(12)
	\$50,330	\$ (138)	\$ 7,537	\$ (26)	\$57,867	\$ (164)
	As of February 28, 2017					
	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Asset-backed securities	\$6,086	\$ (28)	\$ —	\$ —	\$6,086	\$ (28)
Corporate debt securities	35,095	(140)	—	—	35,095	(140)
Foreign government bonds	650	(1)	—	—	650	(1)
Mortgage-backed securities	3,204	(22)	—	—	3,204	(22)
U.S. government agency securities	11,306	(65)	731	(12)	12,037	(77)
U.S. government notes	7,265	(29)	—	—	7,265	(29)
	\$63,606	\$ (285)	\$ 731	\$ (12)	\$64,337	\$ (297)

We periodically review our marketable securities for other-than-temporary impairment. We consider factors such as the duration, severity and the reason for the decline in value, the potential recovery period and whether we intend to sell. For marketable debt securities, we also consider whether (i) it is more likely than not that we will be required to sell the debt securities before recovery of their amortized cost basis and (ii) the amortized cost basis cannot be recovered as a result of credit losses. Unrealized losses related to these investments are due to interest rate fluctuations as opposed to changes in credit quality. We do not intend to sell and it is not more likely than not that we would be required to sell these investments before recovery of their amortized cost basis, which may be at maturity. As of August 31, 2017, we have recognized no other-than-temporary impairment loss.

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The following table summarizes the estimated fair value of our investments in marketable debt securities by contractual maturities (in thousands):

	As of
	August
	31,
	2017
Due in 1 year	\$21,434
Due in 1 year through 5 years	52,893
Due in 5 years through 10 years	3,020
Due after 10 years	3,644
	\$80,991

Fair Value Measurements

We determine fair value based on the fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value assumes that the transaction to sell the asset or transfer the liability occurs in the principal or most advantageous market for the asset or liability and establishes that the fair value of an asset or liability shall be determined based on the assumptions that market participants would use in pricing the asset or liability. The classification of a financial asset or liability within the hierarchy is based upon the lowest level input that is significant to the fair value measurement. The fair value hierarchy prioritizes the inputs into three levels that may be used to measure fair value:

Level 1: Inputs are unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2: Inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument.

Level 3: Inputs are unobservable inputs based on our assumptions.

Cash equivalents and marketable equity securities are classified within Level 1 because they are valued using quoted market prices or alternative pricing sources and models utilizing market observable inputs. Marketable debt securities and derivative assets are classified within Level 2 if the investments are valued using model driven valuations which use observable inputs such as quoted market prices, benchmark yields, reported trades, broker/dealer quotes or alternative pricing sources with reasonable levels of price transparency. Our marketable securities are held by custodians who obtain investment prices from a third-party pricing provider that incorporates standard inputs in various asset price models.

We estimated the fair value of our Level 3 contingent consideration liabilities based on a weighted probability assessment of achieving the milestones related to certain of our acquisitions. Significant increases (decreases) in the probability assumptions in isolation would result in a significantly higher (lower) fair value measurement. In developing these estimates, we considered unobservable inputs that are supported by little or no market activity and reflect our own assumptions.

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Financial assets and liabilities measured at fair value on a recurring basis are summarized below (in thousands):

	As of August 31, 2017			
	Level 1	Level 2	Level 3	Total
Cash equivalents:				
Money market funds	\$16,003	\$—	\$—	\$16,003
Marketable securities:				
Asset-backed securities	\$—	\$9,468	\$—	\$9,468
Corporate debt securities	\$—	\$43,696	\$—	\$43,696
Foreign government bonds	\$—	\$651	\$—	\$651
Mortgage-backed securities	\$—	\$3,399	\$—	\$3,399
U.S. government agency securities	\$—	\$13,647	\$—	\$13,647
U.S. government notes	\$—	\$10,130	\$—	\$10,130

	As of February 28, 2017			
	Level 1	Level 2	Level 3	Total
Cash equivalents:				
Money market funds	\$16,468	\$—	\$—	\$16,468
Marketable securities:				
Asset-backed securities	\$—	\$9,575	\$—	\$9,575
Corporate debt securities	\$—	\$41,693	\$—	\$41,693
Foreign government bonds	\$—	\$649	\$—	\$649
Mortgage-backed securities	\$—	\$3,302	\$—	\$3,302
U.S. government agency securities	\$—	\$12,631	\$—	\$12,631
U.S. government notes	\$—	\$12,065	\$—	\$12,065

Other accrued liabilities (current):				
Contingent consideration	\$—	\$—	\$902	\$902

The following table summarizes the change in fair value of our Level 3 contingent consideration amounts (in thousands):

Balance as of February 28, 2017	\$902
Total remeasurement recognized in earnings	(160)
Settlements	(742)
Balance as of August 31, 2017	\$—

For the six months ended August 31, 2017, the contingent consideration remeasurement was recognized within research and development expense in our condensed consolidated statements of income.

Inventories, Net

Inventories, net consisted of the following (in thousands):

	As of August 31, 2017	As of February 28, 2017
Raw materials	\$3,787	\$ 3,479
Finished goods	3,275	2,878
Reserves	(542)	(510)
	\$6,520	\$ 5,847

Deferred Costs

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Deferred costs consisted of the following (in thousands):

	As of August 31, 2017	As of February 28, 2017
Appliance	\$40,561	\$ 39,474
Commissions	23,891	20,409
	\$64,452	\$ 59,883

Property and Equipment, Net

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

	As of August 31, 2017	As of February 28, 2017
Land	\$9,849	\$ 9,849
Building	6,549	6,549
Computer hardware and software	39,923	32,850
Vehicles, machinery and equipment	4,799	4,797
Leasehold improvements	4,492	4,379
	65,612	58,424
Accumulated depreciation and amortization	(33,569)	(28,445)
	\$32,043	\$ 29,979

Depreciation and amortization expense related to property and equipment was \$2.6 million and \$5.1 million for the three and six months ended August 31, 2017, respectively, and \$2.3 million and \$4.7 million for the three and six months ended August 31, 2016, respectively.

Accumulated Other Comprehensive Income (Loss)

The components of accumulated other comprehensive income (loss) ("AOCI"), net of tax, were as follows (in thousands):

	Foreign Currency Translation Adjustments	Unrealized Gains (Losses) on Available-for- Sale Investments	Total
Balance as of February 28, 2017	\$ (4,954)	\$ (272)	\$(5,226)
Other comprehensive income before reclassifications	1,991	149	2,140
Amounts reclassified from AOCI	—	10	10
Other comprehensive income	1,991	159	2,150
Balance as of August 31, 2017	\$ (2,963)	\$ (113)	\$(3,076)

3. Goodwill and Intangible Assets

The changes in the carrying amount of goodwill are summarized as follows (in thousands):

Balance as of February 28, 2017	\$69,795
Effect of foreign exchange rates	858
Balance as of August 31, 2017	\$70,653

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Intangible assets subject to amortization are summarized as follows (in thousands):

	As of August 31, 2017		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
Acquired developed technology	\$50,296	\$ (32,626)	\$ 17,670
Customer relationships	20,033	(10,594)	9,439
Patents	2,999	(1,991)	1,008
Trade name	812	(432)	380
	\$74,140	\$ (45,643)	\$ 28,497
	As of February 28, 2017		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
Acquired developed technology	\$50,013	\$ (30,105)	\$ 19,908
Customer relationships	19,736	(9,348)	10,388
Patents	2,999	(1,781)	1,218
Trade name	812	(375)	437
	\$73,560	\$ (41,609)	\$ 31,951

Certain intangible assets were removed as they were fully amortized as of the periods presented above. In addition to the above, we maintained other intangible assets not subject to amortization of \$0.2 million as of August 31, 2017 and February 28, 2017.

Amortization expense, including impairment charges, was \$1.8 million and \$3.5 million for the three and six months ended August 31, 2017, respectively, and \$1.8 million and \$3.7 million for the three and six months ended August 31, 2016, respectively.

As of August 31, 2017, amortization expense for intangible assets in future periods was as follows: \$3.4 million for the remainder of fiscal 2018, \$6.0 million for fiscal 2019, \$5.8 million for fiscal 2020, \$5.3 million for fiscal 2021, \$4.9 million for fiscal 2022 and \$3.1 million thereafter.

4. Stockholders' Equity

Stock-Based Compensation

Total stock-based compensation expense has been classified as follows in our condensed consolidated statements of income (in thousands):

	Three Months Ended August 31,		Six Months Ended August 31,	
	2017	2016	2017	2016
Cost of revenue	\$496	\$338	\$922	\$636
Research and development	3,121	2,608	5,808	5,072
Sales and marketing	3,400	1,943	5,534	3,791
General and administrative	2,611	3,007	4,747	6,334
	\$9,628	\$7,896	\$17,011	\$15,833

As of August 31, 2017, there was \$6.1 million of unrecognized compensation cost related to outstanding stock options, expected to be recognized over a weighted-average period of 1.54 years, and \$63.1 million of unrecognized compensation cost related to unvested restricted stock units ("RSUs"), expected to be recognized over a weighted-average period of 2.79 years.

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Our 2015 Employee Stock Purchase Plan (the "ESPP") allows eligible employee participants to purchase shares of our common stock at a discount through payroll deductions. The ESPP consists of offering periods that are six months in length and employees may purchase shares in each period at 85% of the lower of the Company's fair market value on the first trading day of each offering period or on the purchase date. The ESPP will continue until the earlier to occur of (i) the termination of the ESPP by our board of directors, or (ii) June 15, 2035. As of August 31, 2017, we had reserved 750,000 shares of our common stock for issuance under the ESPP and 634,746 shares remain available for future issuance.

Stock Repurchase Program

In 2015, our board of directors authorized a stock repurchase program to repurchase shares of our common stock for an aggregate purchase price not to exceed \$50.0 million through September 30, 2017.

The following table summarizes our common stock repurchases for the periods presented (in thousands, except per share data):

	Three Months		Six Months	
	Ended August 31,		Ended August 31,	
	2017	2016	2017	2016
Total number of shares repurchased	—	464	331	482
Dollar amount of shares repurchased	\$—	\$6,961	\$6,546	\$7,241
Average price paid per share	\$—	\$14.99	\$19.75	\$15.03
Remaining amount authorized as of the period end	\$16,642	\$23,543	\$16,642	\$23,543

5. Income Taxes

For the three and six months ended August 31, 2017, we recorded an income tax provision of \$0.4 million and \$2.9 million, respectively. For the three and six months ended August 31, 2016, we recorded an income tax provision of \$5.2 million and \$8.5 million, respectively.

We maintain a valuation allowance against a significant portion of our deferred tax assets, including U.S. federal and state deferred tax assets and certain foreign deferred tax assets, because realization of these tax benefits through future taxable income did not meet the more-likely-than-not threshold. We intend to maintain the valuation allowance until sufficient positive evidence exists to support its reversal.

The difference between the income tax provision that would be derived by applying the statutory rate to our before tax income for the three and six months ended August 31, 2017 and the income tax provision actually recorded is primarily due to the temporary differences we do not expect to benefit from due to our valuation allowance, as well as non-deductible stock-based compensation expense and other currently non-deductible items.

6. Segment Information

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. Our chief operating decision maker is our chief executive officer. Our chief executive officer reviews financial information presented on a consolidated basis, accompanied by information about sales by geographic region, for purposes of allocating resources and evaluating financial performance. We have one business activity and there are no segment managers who are held accountable for operations, operating results and plans for levels or components below the consolidated level. Accordingly, we have determined that we have a single reportable segment and operating segment structure.

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Revenue by geographic region is based on our customers' billing addresses and is presented as follows (in thousands):

	Three Months		Six Months Ended	
	Ended August 31,		August 31,	
	2017	2016	2017	2016
North America	\$70,384	\$65,855	\$140,571	\$130,952
United States	66,595	62,413	132,857	124,006
Other	3,789	3,442	7,714	6,946
Latin America	1,324	1,225	2,641	2,350
Asia-Pacific	6,010	5,235	11,932	10,284
EMEA	16,607	15,615	33,360	30,998
	\$94,325	\$87,930	\$188,504	\$174,584

7. Borrowings

Credit Facility

We have a \$25.0 million credit facility with Silicon Valley Bank ("SVB"), which expires in November 2017. The credit facility includes an option to request an increase of the available funds to \$50.0 million and is secured by a security interest on substantially all of our assets and contains restrictive covenants. Upon drawing the credit facility, the financial covenants will require us to maintain a minimum adjusted EBITDA, as defined in the credit facility, and a minimum adjusted quick ratio. The credit facility also sets forth specified events of default. No amounts had been drawn under the credit facility through August 31, 2017.

8. Commitments and Contingencies

Legal Matters

On February 27, 2017, Realtime Data LLC ("Realtime Data") filed a lawsuit against us in the United States District Court for the Eastern District of Texas, Tyler Division, alleging that certain of our products infringe U.S. patent numbers 9,054,728, 7,415,530, 9,116,908 and 8,717,204 (the "First Realtime Matter"). On June 2, 2017, we filed a motion to dismiss for improper venue, and on September 22, 2017, we filed a motion to transfer venue of the action from the Eastern District of Texas to the Northern District of California. On July 5, 2017, Realtime Data filed a second lawsuit related to the same patents and products in the United States District Court for the District of Delaware. On September 14, 2017, Realtime Data dismissed the Delaware action without prejudice. Given the early stage of the First Realtime Matter, we are unable to estimate a possible loss or range of possible loss, if any.

We may, from time to time, be party to litigation and subject to claims that arise in the ordinary course of business. In addition, third parties may, from time to time, assert claims against us in the form of letters and other communications. We currently believe that these ordinary course matters will not have a material adverse effect on our business, consolidated financial position, results of operations or cash flows; however, the results of litigation and claims are inherently unpredictable. Regardless of the outcome, litigation can have an adverse impact on us because of defense and settlement costs, diversion of management resources and other factors.

9. Net Income Per Share

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The following table presents the calculation of basic and diluted net income per share (in thousands, except per share amounts):

	Three Months		Six Months	
	Ended August		Ended August	
	31,	31,	31,	31,
	2017	2016	2017	2016
Net income	\$ 1,554	\$ 2,437	\$ 4,226	\$ 5,221
Weighted-average shares used to compute net income per share, basic	53,040	52,265	52,958	52,275
Dilutive shares from stock options and RSUs	1,569	1,056	1,512	813
Weighted-average shares used to compute net income per share, diluted	54,609	53,321	54,470	53,088
Net income per share, basic	\$0.03	\$0.05	\$0.08	\$0.10
Net income per share, diluted	\$0.03	\$0.05	\$0.08	\$0.10

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

You should read the following discussion and analysis of our financial condition and results of operations together with our condensed consolidated financial statements and related notes that are included elsewhere in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the fiscal year ended February 28, 2017. The last day of our fiscal year is February 28/29. Our fiscal quarters end on May 31, August 31, November 30 and February 28/29. This discussion contains forward-looking statements based upon current expectations that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended February 28, 2017.

Overview

Barracuda designs and delivers powerful yet easy-to-use security and data protection solutions. We offer cloud-enabled solutions that empower customers to address security threats, improve network performance and protect and store their data. Our security platform helps customers simplify their IT operations and address their most pressing security needs even as they adopt new deployment models and move applications, data and workloads to the cloud. Our business model is built on the core values of speed and agility, which we apply to all aspects of our approach, including our technology innovations, the delivery and deployment of our solutions and responses to customer inquiries.

We derive revenue from sales of appliances and subscriptions. Revenue from the sale of our appliances includes hardware and a perpetual license. Subscription revenue is generated primarily from our subscription services such as our Barracuda Energize Updates and our cloud solutions. Subscription revenue also includes revenue from fixed term licenses of our managed service provider solutions, virtual appliance software, support and maintenance. Our subscriptions include monthly and annual terms ranging from one to five years, the substantial majority of which are for one-year periods. Subscriptions are billed in advance of the purchased subscription period. Annualized renewal rates from subscriptions, on a dollars basis, were 91% and 92% for the three and six months ended August 31, 2017, respectively, and 102% and 99% for the three and six months ended August 31, 2016, respectively. Subscription annual recurring revenue, which represents the annualized dollar amount of recurring subscription revenue in the final month of the fiscal quarter, was \$299.8 million and \$270.1 million for the six months ended August 31, 2017 and 2016, respectively.

The growth of our business and our future success depend on many factors, including our ability to continue to expand our customer base, pursue cross-sale opportunities and grow revenues from our existing customer base, expand our distribution channels, particularly internationally, continue to develop new solutions to promptly respond to our customers' needs and successfully integrate acquisitions into our business. In aligning our investments, product portfolio and routes to market to address our customers' growing adoption of public cloud, software-as-a-service ("SaaS") and managed service IT deployment models, we provide a security platform that spans email, management, network and application security as well as data protection, all of which can be deployed and centrally managed across diverse and distributed architectures. As our existing customers' IT buying needs evolve, or as our customers realize the benefits of the solutions that they previously purchased, our platform provides us an opportunity to cross-sell additional solutions. To support our cross-sell efforts, we intend to continue adding higher touch sales and marketing field resources to liaise with our channel partners as we continue to grow our sales both domestically and internationally. We expect that our continued investment in resources to expand our cross-sell efforts to existing customers will result in longer-term revenue growth opportunities.

In addition to our cross-sell efforts, our sales and marketing initiatives are primarily focused on higher-growth segments within the security and data protection markets. Our future success will depend in part on our ability to continue to timely identify these higher-growth segments and expand our sales within them. While these areas represent significant opportunities for us, they also pose risks and challenges that we must successfully address in order to sustain the growth of our business and improve our operating results.

Furthermore, our business depends on the overall demand for security and data protection solutions. Weak global economic conditions, particularly market and financial uncertainty and instability in the United States and Europe, or a reduction in security and data protection solution spending even if general economic conditions are unaffected,

could adversely impact our business, financial condition and operating results in a number of ways. Additionally, we face significant competition across all of our market segments, and must continue to execute across all functions and add qualified personnel to succeed.

Our Business Model

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We generally invoice at the time of sale for the total price of the solutions we deliver, and we typically collect cash in 30 to 60 days. We refer to the total amount of invoices we issue in a period as gross billings. All of the gross billings we record are recognized as revenue ratably under U.S. generally accepted accounting principles ("GAAP"), once all revenue recognition criteria have been met. Gross billings are initially recorded as deferred revenue, less reserves. The hardware appliance component of our gross billings is recognized ratably as revenue over the estimated customer relationship period, which is typically three years, commencing upon the activation of the unit by the end customer. The subscription component of our gross billings is recognized ratably as revenue over the contractual period of the subscription. Because we typically bill in advance for the entire term, substantially all of our new and renewal gross billings increase our deferred revenue balance, which contributes significantly to our cash flow.

Components of Results of Operations

Revenue

We generate revenue from the sales of our appliances and subscriptions.

Appliance Revenue. Revenue from the sale of our appliances includes hardware and a perpetual software license. We recognize hardware appliance revenue over the estimated customer relationship period of three years, commencing with the end-user's activation of the appliance and related subscription, provided all other criteria for the recognition of appliance revenue are met.

Subscription Revenue. Subscription revenue is generated primarily from our subscription services such as our Barracuda Energize Updates. Subscription revenue also includes revenue from fixed term licenses of our virtual appliance software, support and maintenance. Our subscription terms include monthly and annual terms ranging from one year to five years, the substantial majority of which are for one year periods. We recognize revenue from subscriptions, support and maintenance over the contractual service period.

Cost of Revenue

Cost of revenue consists of costs related to our appliance and subscription revenue. Such costs include hardware, manufacturing, shipping and logistics, customer support, royalty, warranty, personnel costs, service delivery and data center costs and amortization of intangible assets related to acquired technology. We expect our cost of revenue to increase in absolute dollars, although it may fluctuate as a percentage of total revenue from period to period, as we continue to grow.

Gross Profit

Gross profit as a percentage of total revenue, or gross margin, has been and will continue to be affected by a variety of factors, including manufacturing costs, cost of technical support and the mix of our solutions sold. We expect our gross profit to fluctuate over time depending on the factors described above.

Operating Expenses

Our operating expenses consist of research and development, sales and marketing and general and administrative expenses. Personnel costs are the most significant component of operating expenses and consist of salaries, benefits, bonuses, stock-based compensation expense and travel-related expenses. Operating expenses also include allocated overhead costs for facilities, IT and depreciation. We expect operating expenses to increase in absolute dollars, although they may fluctuate as a percentage of total revenue from period to period, as we continue to grow. In particular, we expect our stock-based compensation expense to increase in absolute dollars as a result of our existing stock-based compensation expense to be recognized as options and restricted stock units ("RSUs") vest and as we issue additional stock-based awards to attract and retain employees.

Research and development. Research and development expenses consist primarily of salaries, benefits and stock-based compensation for employees and executives on our engineering and technical teams who are responsible for increasing the functionality and enhancing the ease-of-use of our appliance and subscription services, as well as the development of new products. We expense our research and development costs as they are incurred. We expect research and development expenses to increase in absolute dollars as we continue to invest in our future solutions, although our research and development expenses may fluctuate as a percentage of total revenue.

Sales and marketing. Our sales and marketing expenses consist primarily of advertising, as well as salaries, commissions, benefits and stock-based compensation for our employees and executives engaged in sales, sales support, marketing, business development and customer service functions. Our advertising expenses include the costs

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of cooperative marketing programs developed with our channel partners and other marketing programs such as online lead generation, promotional events and web seminars. We market and sell our subscription services worldwide through our sales organization and distribution channels, such as strategic resellers and distributors. We capitalize and amortize the direct and incremental portion of our sales commissions over the period the related revenue is recognized. We expect sales and marketing expenses to increase in absolute dollars as we continue to introduce marketing campaigns and invest in sales resources in key focus areas, although our sales and marketing expenses may fluctuate as a percentage of total revenue.

General and administrative. Our general and administrative expenses consist primarily of salaries, benefits and stock-based compensation for our finance, legal, regulatory and compliance, human resources and other administrative employees and executives. In addition, general and administrative expenses include outside consulting, legal and accounting services and facilities and other supporting overhead costs. We expect general and administrative expenses to increase in absolute dollars due to professional services fees primarily related to outside legal, audit, investor relations and consulting services to support the business, although our general and administrative expenses may fluctuate as a percentage of total revenue.

Other Income, Net

Other income, net consists primarily of foreign exchange gains and losses, interest expense on our outstanding debt and interest income earned on our cash, cash equivalents and marketable securities, as well as realized gains and losses from our marketable securities portfolio. We expect interest income will vary each reporting period depending on our average investment balances during the period, types and mix of investments and market interest rates.

Provision for Income Taxes

In fiscal year ended February 28, 2015, we established a valuation allowance against a significant portion of our deferred tax assets, including U.S. federal and state deferred tax assets and certain foreign deferred tax assets, because realization of these tax benefits through future taxable income did not meet the more-likely-than-not threshold. We intend to maintain the valuation allowance until sufficient positive evidence exists to support its reversal.

The difference between the income tax provision that would be derived by applying the statutory rate to our income before tax for the three and six months ended August 31, 2017 and the income tax provision actually recorded is primarily due to the temporary differences, which we do not expect to benefit from due to our valuation allowance, as well as the non-deductible stock-based compensation expense and other currently non-deductible items.

Results of Operations

Comparison of the Three Months Ended August 31, 2017 and 2016

The following table summarizes our condensed consolidated results of operations for the periods presented and as a percentage of our total revenue for those periods (dollars in thousands):

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	Three Months Ended August 31,					
	2017	% of Total Revenue		2016	% of Total Revenue Change	
Revenue:						
Appliance	\$18,347	19	%	\$21,034	24	% \$(2,687)
Subscription	75,978	81		66,896	76	9,082
Total revenue	94,325	100		87,930	100	6,395
Cost of revenue	25,198	27		20,240	23	4,958
Gross profit	69,127	73		67,690	77	1,437
Operating expenses:						
Research and development	19,440	20		18,446	21	994
Sales and marketing	38,561	41		32,144	37	6,417
General and administrative	10,338	11		10,969	12	(631)
Total operating expenses	68,339	72		61,559	70	6,780
Income from operations	788	1		6,131	7	(5,343)
Other income, net	1,124	1		1,515	2	(391)
Income before income taxes	1,912	2		7,646	9	(5,734)
Provision for income taxes	(358)	—		(5,209)	(6)	4,851
Net income	\$1,554	2	%	\$2,437	3	% \$(883)

Revenue

Total revenue increased \$6.4 million, or 7%, for the three months ended August 31, 2017 compared to the three months ended August 31, 2016. Subscription revenue increased by \$9.1 million, or 14%, for the three months ended August 31, 2017 compared to the three months ended August 31, 2016, primarily driven by an increase in active subscribers during the period of 49,348, or 17%, from 298,739 active subscribers as of August 31, 2016 to 348,087 active subscribers as of August 31, 2017. The increase in active subscribers was primarily driven by our high level of customer retention and an increase in the number of customers purchasing subscriptions from us. Total appliance revenue decreased by \$2.7 million, or 13%, primarily due to the continuing shift by our customers from traditional and solely on-premises deployments to include the cloud, which includes hybrid network architectures, public and/or private clouds, SaaS applications and managed service solutions.

Cost of Revenue and Gross Margin

Cost of revenue increased \$5.0 million, or 24%, for the three months ended August 31, 2017 compared to the three months ended August 31, 2016. Gross margin decreased from 77% for the three months ended August 31, 2016 to 73% for the three months ended August 31, 2017, primarily due to product mix shifts and increases of \$1.6 million in warranty costs, \$1.2 million in service delivery costs, \$0.8 million in compensation and personnel costs, \$0.8 million increase in provision for inventory obsolescence and \$0.6 million in royalty costs. Additionally, our gross margin is generally impacted by the timing of investments in our data center infrastructure and our technical support.

Operating Expenses

Research and development expenses increased \$1.0 million, or 5%, for the three months ended August 31, 2017 compared to the three months ended August 31, 2016, primarily due to increases of \$0.5 million in stock-based compensation expense costs and \$0.4 million in compensation and personnel costs, each primarily attributable to additional headcount, as well as a \$0.1 million increase in travel related costs. As a percentage of total revenue, research and development expenses remained relatively consistent period over period.

Sales and marketing expenses increased \$6.4 million, or 20%, for the three months ended August 31, 2017 compared to the three months ended August 31, 2016, primarily due to increases of \$4.5 million in compensation and personnel costs, primarily attributable to additional headcount and sales commission attainment, \$1.4 million in stock-based compensation expense, primarily attributable to the acceleration of a departing executive's equity grants, and \$0.5 million in travel and other related costs. As a percentage of total revenue, sales and marketing expenses increased for the comparable period primarily due to the timing and nature of marketing campaigns.

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General and administrative expenses on a dollar basis remained relatively consistent for the three months ended August 31, 2017 compared to the three months ended August 31, 2016, There was a decrease of \$0.6 million in legal costs and a decrease of \$0.4 million in stock-based compensation expense, partially offset by an increase of \$0.2 million in compensation and personnel costs and a \$0.2 million increase in consulting costs. As a percentage of total revenue, general and administrative expenses remained relatively consistent for the comparable period.

Other Income, Net

The change in other income, net was primarily due to a decrease of \$0.7 million in realized gain on sale of investments in marketable equity securities, partially offset by increases of \$0.2 million in other investment gains and \$0.1 million in net foreign exchange gains during the three months ended August 31, 2017 compared to the three months ended August 31, 2016.

Provision for Income Taxes

We recorded an income tax provision of \$0.4 million for the three months ended August 31, 2017. The difference between the income tax provision that would be derived by applying the statutory rate to our before tax income for the three months ended August 31, 2017 and the income tax provision actually recorded is primarily due to the temporary differences, which we do not expect to benefit from due to our valuation allowance, as well as non-deductible stock-based compensation expense and other currently non-deductible items. For the three months ended August 31, 2016, we recorded an income tax provision of \$5.2 million.

Comparison of the Six Months Ended August 31, 2017 and 2016

The following table summarizes our condensed consolidated results of operations for the periods presented and as a percentage of our total revenue for those periods (dollars in thousands):

	Six Months Ended August 31,					
	2017	% of Total Revenue		2016	% of Total Revenue Change	
Revenue:						
Appliance	\$38,612	20	%	\$42,367	24	% \$(3,755)
Subscription	149,892	80		132,217	76	17,675
Total revenue	188,504	100		174,584	100	13,920
Cost of revenue	48,846	26		40,481	23	8,365
Gross profit	139,658	74		134,103	77	5,555
Operating expenses:						
Research and development	38,796	20		37,653	22	1,143
Sales and marketing	74,781	40		63,474	36	11,307
General and administrative	21,282	11		21,741	12	(459)
Total operating expenses	134,859	71		122,868	70	11,991
Income from operations	4,799	3		11,235	7	(6,436)
Other income, net	2,308	1		2,505	1	(197)
Income before income taxes	7,107	4		13,740	8	(6,633)
Provision for income taxes	(2,881)	(2)		(8,519)	(5)	5,638
Net income	\$4,226	2	%	\$5,221	3	% \$(995)

Revenue

Total revenue increased \$13.9 million, or 8%, for the six months ended August 31, 2017 compared to the six months ended August 31, 2016. Subscription revenue increased by \$17.7 million, or 13%, for the six months ended August 31, 2017 compared to the six months ended August 31, 2016, primarily due to an increase in active subscribers during the period of 49,348, or 17%, from 298,739 active subscribers as of August 31, 2016 to 348,087 active subscribers as of August 31, 2017. The increase in active subscribers primarily resulted from our high level of customer retention and an increase in the number of

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customers purchasing subscriptions. Total appliance revenue decreased by \$3.8 million, or 9%, primarily due to the continuing shift by our customers from traditional and solely on-premises deployments to include the cloud, which includes hybrid network architectures, public and/or private clouds, SaaS applications and managed service solutions.

Cost of Revenue and Gross Margin

Cost of revenue increased \$8.4 million, or 21%, for the six months ended August 31, 2017 compared to the six months ended August 31, 2016. Gross margin decreased from 77% for the six months ended August 31, 2016 to 74% for the six months ended August 31, 2017, primarily due to product mix shifts and increases of \$3.3 million in warranty costs, \$1.7 million in service delivery costs, \$1.4 million in compensation and personnel costs, \$1.1 million in royalty costs, \$0.8 million increase in provision for inventory obsolescence and \$0.3 million in stock-based compensation expense. Additionally, our gross margin is generally impacted by the timing of investments in our data center infrastructure and our technical support.

Operating Expenses

Research and development expenses increased \$1.1 million, or 3%, for the six months ended August 31, 2017 compared to the six months ended August 31, 2016, primarily due to increases of \$0.7 million in stock-based compensation expense, \$0.6 million in compensation and personnel costs, \$0.2 million in travel and other related costs and \$0.1 million in consulting costs, partially offset by decreases of \$0.2 million in internal use development equipment and service, \$0.2 million in professional services and \$0.1 million in IT-related infrastructure expenses. As a percentage of total revenue, research and development expenses remained relatively consistent period over period. Sales and marketing expenses increased \$11.3 million, or 18%, for the six months ended August 31, 2017 compared to the six months ended August 31, 2016, primarily due to increases of \$6.6 million in compensation and personnel costs, primarily attributable to an increase in headcount, \$1.8 million in marketing and channel partner program expenses, primarily attributable to higher search engine marketing, sponsorship and advertising spend and event and trade show costs, \$1.7 million in stock-based compensation expense, \$1.1 million in travel and other related costs and \$0.2 million in license and service fees, partially offset by decreases of \$0.2 million in amortization expense of intangible assets. As a percentage of total revenue, sales and marketing expenses increased for the comparable period mainly due to the timing and nature of marketing campaigns. We expect sales and marketing expenses to increase on a dollar basis and as a percentage of total revenue for the remainder of fiscal 2018 as we invest in sales resources in key focus areas.

General and administrative expenses decreased \$0.5 million, or 2%, for the six months ended August 31, 2017 compared to the six months ended August 31, 2016, primarily due to decreases of \$1.6 million in stock-based compensation expense, \$0.6 million in legal costs, \$0.4 million gain in sale of CudaCam, \$0.2 million in bad debt expenses, \$0.1 million in credit card processing fees and \$0.1 million in insurance expense partially offset by increases of \$1.7 million in taxes, \$0.4 million in compensation and personnel costs, \$0.3 million in consulting costs and \$0.1 million in travel and other related costs. As a percentage of total revenue, general and administrative expenses remained relatively consistent period over period.

Other Income, Net

The change in other income, net was primarily due to \$1.1 million in realized gain on sale of investment in marketable equity securities, partially offset by \$0.5 million in foreign exchange losses, a \$0.3 million loss in other investments and a \$0.1 million decrease in miscellaneous income during the six months ended August 31, 2017 compared to the six months ended August 31, 2016.

Provision for Income Taxes

We recorded an income tax provision of \$2.9 million for the six months ended August 31, 2017. The difference between the income tax provision that would be derived by applying the statutory rate to our before tax income for the six months ended August 31, 2017 and the income tax provision actually recorded is primarily due to the temporary differences, which we do not expect to benefit from due to our valuation allowance, as well as non-deductible stock-based compensation expense and other currently non-deductible items. For the six months ended August 31, 2016, we recorded an income tax provision of \$8.5 million.

Liquidity and Capital Resources

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Six Months Ended
August 31,
2017 2016

(in thousands)

Net cash provided by operating activities	\$31,210	\$32,607
Net cash used in investing activities	\$(14,299)	\$(8,313)
Net cash used in financing activities	\$(12,838)	\$(4,260)

As of August 31, 2017, we had cash and cash equivalents of \$125.6 million, of which approximately \$19.9 million was held outside of the United States and not presently available to fund domestic operations and obligations. In addition, we held marketable securities of \$81.0 million as of August 31, 2017. If we were to repatriate cash held outside of the United States, it could be subject to U.S. income taxes, less any previously paid foreign income taxes. Our \$25.0 million credit facility with Silicon Valley Bank (“SVB”) expires in November 2017. The credit facility includes an option to request an increase of the available funds to \$50.0 million and is secured by a security interest on substantially all of our assets and contains restrictive covenants. Upon drawing the credit facility, the financial covenants will require us to maintain a minimum adjusted EBITDA, as defined in the credit facility, and a minimum adjusted quick ratio. The credit facility also sets forth specified events of default. No amounts had been drawn under the credit facility through August 31, 2017.

We believe that our existing cash, cash equivalents and marketable securities, our available credit facility and net cash provided by operating activities will be sufficient to meet our working capital and capital expenditure requirements, as well as to fund any principal and interest payments on notes payable and repurchases of our common stock, for at least the next 12 months. 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 solutions and service offerings and the continuing market acceptance of our solutions. In the event that additional financing is required from outside sources, we may not be able to raise it on terms acceptable to us or at all. If we are unable to raise additional capital when desired, our business, operating results and financial condition would be adversely affected.

In addition, as described in the section "Legal Proceedings" included in Part II, Item 1 of this Quarterly Report on Form 10-Q, we are currently involved in ongoing litigation. Any adverse settlements or judgments in any litigation could have a material adverse impact on our results of operations, cash balances and cash flows in the period in which such events occur.

Operating Activities

Our primary source of cash from operating activities has been from cash collections from our customers. We expect cash inflows from operating activities to be affected by increases in sales and timing of collections. Our primary uses of cash from operating activities have been for personnel costs and investment in sales and marketing and research and development infrastructure. We expect cash outflows from operating activities to be affected by increases in sales and increases in personnel costs as we grow our business.

For the six months ended August 31, 2017, operating activities provided \$31.2 million in cash primarily due to non-cash charges of \$25.6 million related to stock-based compensation, depreciation and amortization expenses, a positive change of \$0.9 million in our net operating assets and liabilities and our consolidated net income of \$4.2 million.

For the six months ended August 31, 2016, operating activities provided \$32.6 million in cash primarily due to non-cash charges of \$24.3 million related to stock-based compensation, depreciation and amortization expenses and our consolidated net income of \$5.2 million and a positive change of \$4.2 million in our net operating assets and liabilities.

Investing Activities

Our investing activities have generally consisted of transactions related to marketable and non-marketable securities, purchases of property and equipment and activity in connection with acquisitions. We expect to continue to purchase property and equipment to support the continued growth of our business as well as continue to invest in our data

center infrastructure.

Cash used in investing activities of \$14.3 million in the six months ended August 31, 2017 was primarily related to purchases of marketable securities of \$21.8 million, property and equipment of \$7.8 million and non-marketable securities of \$4.0 million as well as payments of \$0.5 million related to an acquisition and the sale of net liabilities of \$0.8 million, partially offset by proceeds from the sale and maturity of certain marketable securities of \$20.6 million.

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Cash used in investing activities of \$8.3 million in the six months ended August 31, 2016 was primarily related to purchases of marketable securities of \$21.8 million, property and equipment of \$3.0 million, intangible assets of \$1.0 million and non-marketable investments of \$0.6 million, partially offset by proceeds from the sale and maturity of certain marketable securities of \$18.3 million.

Our annual capital expenditures generally have varied between approximately 2% and 5% of annual total revenue. We believe future capital expenditures are likely to be consistent with historical experience with variations above or below the range depending upon specific strategic opportunities.

Financing Activities

Our financing activities generally consist of equity related transactions, including proceeds from the exercises of employee stock options, excess tax benefits from equity incentive plans and tax payments associated with the net share settlements of equity awards and repurchases of common stock.

For the six months ended August 31, 2017, financing activities used \$12.8 million in cash primarily related to repurchases of our common stock of \$6.5 million, tax payments related to \$4.5 million of net share settlements of equity awards and payments related to contingent considerations of \$0.7 million, partially offset by proceeds from stock option exercises of \$3.0 million.

For the six months ended August 31, 2016, financing activities provided \$4.3 million in cash primarily related to repurchases of our common stock of \$7.2 million and tax payments related to \$2.5 million of net share settlements of equity awards, partially offset by proceeds from stock option exercises of \$4.9 million.

Key Metrics

We monitor the following key metrics to help us evaluate growth trends, establish budgets and assess operational efficiencies. In addition to our results determined in accordance with GAAP, we believe the following non-GAAP and operational measures are useful in evaluating our operating performance.

The following presents our key metrics and provides reconciliations of the most directly comparable GAAP financial measure to each non-GAAP financial measure (in thousands, except active subscribers and percentages).

	Three Months Ended August 31,		Six Months Ended August 31,		
	2017	2016	2017	2016	
Gross billings	\$108,498	\$100,298	\$213,722	\$198,499	
Year-over-year percentage change	8	% 2	% 8	% 3	%
Year-over-year percentage change on a constant currency basis ⁽¹⁾	8	% 2	% 8	% 3	%
Adjusted EBITDA ⁽²⁾	\$15,598	\$18,622	\$32,127	\$36,336	
Adjusted EBITDA as a percentage of total revenue	17	% 21	% 17	% 21	%
Free cash flow ⁽²⁾	\$7,922	\$19,450	\$23,394	\$29,638	
Free cash flow as a percentage of total revenue	8	% 22	% 12	% 17	%
Active subscribers at period end	348,087	298,739	348,087	298,739	

⁽¹⁾ In order to determine how our business performed exclusive of the effect of foreign currency fluctuations, we compare the percentage change in our gross billings from one period to another using a constant currency. To present this gross billings information, the current and comparative prior period results for entities that operate in other than U.S. dollars are converted into U.S. dollars at constant exchange rates. For example, the average exchange rates for the second quarter of fiscal 2018 were used to convert current and comparable prior period gross billings rather than the actual exchange rates in effect during the respective period.

Beginning in the third quarter of fiscal 2017, we modified our reporting practices and our historical presentation of adjusted EBITDA by no longer adjusting for changes in deferred revenue and associated deferred costs.

⁽²⁾ Additionally, we have modified our historical presentation of adjusted free cash flow and will no longer adjust free cash flow for cash payment impact of acquisition and other charges. Refer to the "Acquisition and Other Charges" section below for

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additional details. These changes do not impact our current and historical presentation of GAAP results. Prior period information has been recast to conform to the adjusted calculations.

Gross billings. We define gross billings as total revenue plus the change in deferred revenue and other adjustments which primarily reflect returns and reserves during a particular period. We use gross billings as a performance measurement, based on our business model of invoicing our customers at the time of sale of our solutions and recognizing revenue ratably over subsequent periods. Accordingly, we believe gross billings provide valuable insight into the sales of our solutions and the performance of our business. The gross billings we record in any period reflect sales to new customers plus renewals and additional sales to existing customers adjusted for returns, rebates and other offsets, which we do not expect to be recognized as revenue in future periods. In many cases, these returns, rebates and other offsets occur in periods different from the period of sale and are unrelated to the marketing efforts leading to the initial sale, and therefore by adjusting for such offsets, we believe our computation of gross billings better reflects the effectiveness of our sales and marketing efforts.

The following table reconciles total revenue to gross billings (in thousands, except percentages):

	Three Months Ended		Six Months Ended		
	August 31,		August 31,		
	2017	2016	2017	2016	
Total revenue	\$94,325	\$87,930	\$188,504	\$174,584	
Total deferred revenue, end of period	413,665	398,878	413,665	398,878	
Less: total deferred revenue, beginning of period	(407,524)	(393,072)	(407,082)	(392,774)	
Add: deferred revenue adjustments	8,032	6,562	18,635	17,811	
Total change in deferred revenue and adjustments	14,173	12,368	25,218	23,915	
Gross billings	\$108,498	\$100,298	\$213,722	\$198,499	
Year-over-year percentage change	8	% 2	% 8	% 3	%
Year-over-year percentage change on a constant currency basis ⁽¹⁾	8	% 2	% 8	% 3	%

In order to determine how our business performed exclusive of the effect of foreign currency fluctuations, we compare the percentage change in our gross billings from one period to another using a constant currency. To present this gross billings information, the current and comparative prior period results for entities that operate in other than U.S. dollars are converted into U.S. dollars at constant exchange rates. For example, the average exchange rates for the second quarter of fiscal 2018 were used to convert current and comparable prior period gross billings rather than the actual exchange rates in effect during the respective period.

In the three and six months ended August 31, 2017, gross billings increased 8% over the prior year's comparable period. The increase in gross billings were primarily driven by our continued ability to cross-sell additional solutions to existing customers and the growth in our renewal subscriptions as a result of our high level of customer retention as well as additional lead generation opportunities and associated new customer billings. For the three and six months ended August 31, 2017, increased sales of our core products were the primary drivers for the increased gross billings. When evaluating our gross billings from period to period, we also evaluate our gross billings for the comparable period using a fixed exchange rate, thereby excluding the effect of currency fluctuations.

Adjusted EBITDA. We define adjusted EBITDA as net income plus non-cash and non-operating charges, which include: (i) other income, net, (ii) provision for income taxes, (iii) acquisition and other charges, (iv) stock-based compensation expense, (v) amortization of intangible assets, including certain losses on disposal and impairment of intangible assets, and (vi) depreciation expense, including certain losses on disposal of fixed assets. Because adjusted EBITDA excludes certain non-cash and non-operating charges, this measure enables us to eliminate the impact of items we do not consider indicative of our ongoing operating performance, and therefore provides a better indication of profitability from our operations, and provides a consistent measure of our performance from period to period. Prior period information has been recast to conform to the current period presentation of adjusted EBITDA and exclude changes in deferred revenue and associated deferred costs in our calculation of adjusted EBITDA.

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The following table reconciles net income to adjusted EBITDA (in thousands, except percentages):

	Three Months Ended		Six Months Ended	
	August 31,		August 31,	
	2017	2016	2017	2016
Net income	\$ 1,554	\$ 2,437	\$ 4,226	\$ 5,221
Other income, net	(1,124)	(1,515)	(2,308)	(2,505)
Provision for income taxes	358	5,209	2,881	8,519
Depreciation, amortization and impairment expense ⁽¹⁾	4,327	4,186	8,543	8,467
Stock-based compensation expense	9,628	7,896	17,011	15,833
Acquisition and other charges ⁽²⁾	855	409	1,774	801
Adjusted EBITDA	\$ 15,598	\$ 18,622	\$ 32,127	\$ 36,336
Adjusted EBITDA as a percentage of total revenue	17	% 21	% 17	% 21

⁽¹⁾ Represents expenses for the amortization of intangible assets and property and equipment, as well as certain losses on disposal and impairment of long-lived assets.

In calculating adjusted EBITDA, we also adjust for acquisition and other charges that we believe are non-recurring, infrequent and/or unusual in nature, can vary significantly in amount and frequency and are

⁽²⁾ unrelated to our ongoing operating performance. We believe that adjusting for these charges allows us to better compare adjusted EBITDA from period to period in order to assess the ongoing operating results of our business.

Refer to the "Acquisition and Other Charges" section below for additional details regarding these charges.

Adjusted EBITDA decreased to \$15.6 million in the three months ended August 31, 2017 from \$18.6 million in the three months ended August 31, 2016. The decrease in adjusted EBITDA was primarily driven by increased sales and marketing expenses due to the timing and nature of certain marketing campaigns and gross margin decreases due to increased warranty costs, investments in employees, cloud infrastructure and core product lines to support the growth in core billings.

Free cash flow. We define free cash flow as net cash provided by operating activities, less purchases of property and equipment. We consider free cash flow to be a useful liquidity measure that considers the investment in cloud and corporate infrastructure required to support our business. We use free cash flow to assess our business performance and evaluate the amount of cash generated by our business after adjusting for purchases of property and equipment. Prior period information has been recast to conform to the current period presentation of free cash flow and excludes the cash payment impact of acquisition and other charges in our calculation of free cash flow.

The following table reconciles net cash provided by operating activities to free cash flow (in thousands, except percentages):

	Three Months Ended		Six Months Ended	
	August 31,		August 31,	
	2017	2016	2017	2016
Net cash provided by operating activities	\$ 11,001	\$ 20,470	\$ 31,210	\$ 32,607
Less: purchases of property and equipment	(3,079)	(1,020)	(7,816)	(2,969)
Free cash flow	\$ 7,922	\$ 19,450	\$ 23,394	\$ 29,638
Free cash flow as a percentage of total revenue	8	% 22	% 12	% 17

Free cash flow decreased to \$7.9 million in the three months ended August 31, 2017 from \$19.5 million in the three months ended August 31, 2016, primarily driven by a \$9.5 million decrease in net cash provided by operating activities, and by additional investments in property and equipment of \$2.1 million.

Active subscribers. We define an active subscriber as a discrete appliance, virtual appliance or cloud-only service that has activated at least one valid subscription that has not been terminated. We monitor the total number of active subscribers as a measure of the growth in our installed base, the success of our sales and marketing activities and the value that our solutions bring to our customers. As of August 31, 2017 and 2016, we had 348,087 and 298,739 active subscribers, respectively. The increase in active subscribers over these periods is primarily related to our ability to attract and acquire new customers.

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Our non-GAAP measures have limitations as analytical tools and you should not consider them in isolation or as a substitute for an analysis of our results under GAAP. There are a number of limitations related to the use of these non-GAAP financial measures versus their nearest GAAP equivalents. First, gross billings, adjusted EBITDA and free cash flow are not substitutes for total revenue, net income and cash provided by operating activities, respectively. Second, other companies may calculate non-GAAP financial measures differently or may use other measures to evaluate their performance, all of which could reduce the usefulness of our non-GAAP financial measures as tools for comparison. Finally, adjusted EBITDA excludes some costs, namely, non-cash stock-based compensation and depreciation, amortization and impairment expenses, which are recurring. Therefore adjusted EBITDA does not reflect the non-cash impact of stock-based compensation expense or working capital needs that will continue for the foreseeable future.

Acquisition and Other Charges

In calculating adjusted EBITDA, we exclude certain expense items resulting from acquisitions and other charges, which we believe are non-recurring, infrequent and/or unusual in nature, can vary significantly in amount and frequency and are unrelated to our ongoing operating performance indicative of ongoing operating performance or do not expect to recur in our continuing operating results. We believe that adjusting for these charges allows us to better compare adjusted EBITDA from period to period in order to assess the ongoing operating results of our business. We refer to these costs as our "acquisition and other charges" throughout this Quarterly Report on Form 10-Q. These costs consist of the following:

Acquisition and other costs. Acquisition costs (including costs associated with prospective acquisitions) include acquisition-related expenses for legal, accounting and other professional fees, integration costs, fair value remeasurements of contingent consideration obligations and contingent consideration payments made under the terms of acquisition agreements. We believe these costs are unpredictable, can vary based on the size and complexity of each transaction, and are unrelated to our core operations or those of acquired businesses. Other costs are non-recurring, infrequent and/or unusual in nature and can vary significantly in amount and frequency. In fiscal 2017, these other costs included legal expenses incurred in connection with the C2C litigation matter. The acquisition and other costs are classified within operating expenses in our condensed consolidated statements of income.

Export compliance. Export compliance costs include the settlement payments and the legal expenses incurred in connection with an internal investigation of our export controls compliance procedures and the submission and final resolution of all issues associated with our voluntary self-disclosures to the U.S. government in this regard. These costs are classified as general and administrative expenses in our condensed consolidated statements of income.

Gain on sale of net liabilities. Gain on sale of net liabilities resulted from the disposition of assets and liabilities related to our CudaCam product offerings. We believe this gain is unrelated to our ongoing operating performance and is not expected to recur in our continuing operating results. The net liabilities included as part of the disposal group resulted in a gain recognized within general and administrative expenses in our condensed consolidated statements of income.

Indirect tax costs. Indirect tax costs represent a one-time reserve based on estimated exposure related to potential tax assessments in various U.S. states. We believe these costs are unpredictable and can vary based on interpretation and application of various U.S. state regulations associated with indirect taxes. These costs are classified as general and administrative expenses in our condensed consolidated statements of income.

The following table presents the details of our acquisition and other charges and their impact on adjusted EBITDA (in thousands):

	Three Months Ended August 31, 2017		Six Months Ended August 31, 2016	
Acquisition and other costs	\$855	\$409	\$519	\$790
Export compliance	—	—	—	11
Gain on sale of net liabilities	—	—	(449)	—

Indirect tax costs	—	—	1,704	—
	\$855	\$409	\$1,774	\$801
Contractual Obligations and Commitments				

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There have been no material changes outside the ordinary course of our business in the contractual obligations disclosed in our Annual Report on Form 10-K for the fiscal year ended February 28, 2017.

Off-Balance Sheet Arrangements

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

Critical Accounting Policies and Estimates

Our condensed consolidated financial statements have been prepared in accordance with GAAP. The preparation of these condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, expenses and related disclosures. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. We evaluate our estimates and assumptions on an ongoing basis. Actual results may differ from these estimates. To the extent that there are material differences between these estimates and our actual results, our future financial statements will be affected.

There have been no significant changes to our critical accounting policies and estimates as disclosed in our Annual Report on Form 10-K for the fiscal year ended February 28, 2017.

JOBS Act Accounting Election

We are an "emerging growth company," as defined in the Jumpstart Our Business Startup Act of 2012 (the "JOBS Act"). Under the JOBS Act, emerging growth companies can delay adopting new or revised accounting standards issued subsequent to the enactment of the JOBS Act until such time as those standards apply to private companies. We have irrevocably elected not to avail ourselves of this exemption from new or revised accounting standards, and, therefore, will be subject to the same new or revised accounting standards as other public companies that are not emerging growth companies.

Emerging Growth Company Status

On August 31, 2017, the last day of our second fiscal quarter, the value of common equity securities held by non-affiliates exceeded \$700 million. As such, we will cease to be an "emerging growth company" on February 28, 2018.

As an "emerging growth company" we have chosen to rely on such exemptions and are therefore not required to, among other things, (i) provide an auditor's attestation report on our system of internal controls over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act, and (ii) provide all of the compensation disclosure that may be required of non-emerging growth public companies under the Dodd-Frank Wall Street Reform and Consumer Protection Act. Commencing February 28, 2018, we will no longer qualify as an emerging growth company and therefore will no longer be able to rely on such exemptions.

Recent Accounting Pronouncements

Refer to the "Recently Adopted Accounting Pronouncements" and "Recent Accounting Pronouncements" sections in Note 1 to our Condensed Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The market risk exposures described in Part II, Item 7A of our Annual Report on Form 10-K for the fiscal year ended February 28, 2017 have not changed materially during the six months ended August 31, 2017.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. Management, with the participation of our chief executive officer ("CEO") and our chief financial officer ("CFO"), evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on

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Form 10-Q. The term "disclosure controls and procedures," as defined in Rules 13a-15 and 15d-15 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 Securities and Exchange Commission's (the "SEC") 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. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives, and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of August 31, 2017, our CEO and CFO concluded that our disclosure controls and procedures were effective at a reasonable assurance level.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15 and 15d-15 of the Exchange Act that occurred during the quarter ended August 31, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations of Internal Controls

Our management, including our CEO and CFO, does not expect that our disclosure controls and procedures or our internal controls over financial reporting will prevent or detect all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. 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 the 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

On February 27, 2017, Realtime Data LLC ("Realtime Data") filed a lawsuit against us in the United States District Court for the Eastern District of Texas, Tyler Division, alleging that certain of our products infringe U.S. patent numbers 9,054,728, 7,415,530, 9,116,908 and 8,717,204 (the "First Realtime Matter"). On June 2, 2017, we filed a motion to dismiss for improper venue and on September 22, 2017, we filed a motion to transfer venue of the action from the Eastern District of Texas to the Northern District of California. On July 5, 2017, Realtime Data filed a second lawsuit related to the same patents and products in the United States District Court for the District of Delaware. On September 14, 2017, Realtime Data dismissed the Delaware action without prejudice. Given the early stage of the First Realtime Matter, we are unable to estimate a possible loss or range of possible loss, if any.

We may, from time to time, be party to litigation and subject to claims that arise in the ordinary course of business. In addition, third parties may, from time to time, assert claims against us in the form of letters and other communications. We currently believe that these ordinary course matters will not have a material adverse effect on our business, consolidated financial position, results of operations or cash flows; however, the results of litigation and claims are inherently unpredictable. Regardless of the outcome, litigation can have an adverse impact on us because of defense and settlement costs, diversion of management resources and other factors.

Item 1A. Risk Factors

Our operations and financial results are subject to various risks and uncertainties, including those referred to below. The risks and uncertainties referred to below are not the only ones we face. Additional risks and uncertainties that we are unaware of, or that we currently believe are not material, may also become important factors that affect us. If any of the following risks occur, our business, financial condition, operating results and prospects could be materially and adversely affected. In that event, the price of our common stock could decline. You should carefully consider the risks and uncertainties described in our most recent Annual Report on Form 10-K, together with all of the other information in this Quarterly Report on Form 10-Q, before making a decision to invest in our common stock.

A description of the risks associated with our business, financial condition, and results of operations is set forth in Part I, Item 1A, of our Annual Report on Form 10-K for the fiscal year ended February 28, 2017. There have been no material changes in our risks from such description.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

a) Sale of Unregistered Securities

Not applicable.

b) Issuer Purchases of Equity Securities

In September 2015, our board of directors authorized a stock repurchase program. Under the program, we are authorized to repurchase shares of our common stock for an aggregate purchase price not to exceed \$50.0 million through September 30, 2017. We began repurchasing common stock in the third quarter of fiscal 2016 and no shares were purchased other than through our stock repurchase program. No shares were repurchased during the three months ended August 31, 2017. As of August 31, 2017, the maximum dollar value balance of shares that may be purchased through September 30, 2017 under our publicly announced stock repurchase program was \$16,642.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

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Item 5. Other Information

Not applicable.

Item 6. Exhibits

The exhibits listed in the accompanying Exhibit Index are filed or incorporated by reference as part of this Quarterly Report on Form 10-Q.

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EXHIBIT INDEX

Exhibit Number	Description	Incorporated By Reference	
		FormFile No.	ExhibitFiling Date
10.1	<u>Resignation Agreement, between the Company and Michael Perone, dated June 29, 2017</u>	8-K 001-36162	10.1 June 30, 2017
31.1	<u>Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act</u>		
31.2	<u>Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act</u>		
32.1*	<u>Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act</u>		
32.2*	<u>Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act</u>		
101.INS	XBRL Instance Document		
101.SCH	XBRL Taxonomy Extension Schema Document		
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document		
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document		
101.LAB	XBRL Taxonomy Extension Label Linkbase Document		
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document		

The certifications attached as Exhibit 32.1 and 32.2 that accompany this Quarterly Report on Form 10-Q are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference into any * filing of Barracuda Networks, Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Quarterly Report on Form 10-Q, irrespective of any general incorporation language contained in such filing.

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SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

BARRACUDA NETWORKS,
INC.

Date: October 10, 2017 By: /s/ William D. Jenkins, Jr.
William D. Jenkins, Jr.
Chief Executive Officer
(Principal Executive Officer)

Date: October 10, 2017 By: /s/ Dustin Driggs
Dustin Driggs
Chief Financial Officer
(Principal Financial Officer)