VEEVA SYSTEMS INC
Form 10-Q
September 06, 2018
Table of Contents

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 July 31, 2018

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: 001-36121

Veeva Systems Inc.

(Exact name of registrant as specified in its charter)

Delaware	20-8235463
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

4280 Hacienda Drive	
Pleasanton, California	94588
(Address of principal executive offices)	(Zip Code)

(Registrant's telephone number, including area code) (925) 452-6500

(Former name, former address and former fiscal year, if changed since last report) N/A

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

As of August 31, 2018, there were 121,826,207 shares of the Registrant's Class A common stock outstanding and 22,683,180 shares of the Registrant's Class B common stock outstanding.

VEEVA SYSTEMS INC.

FORM 10-Q

TABLE OF CONTENTS

Table of Contents

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements that are based on our beliefs and assumptions and on information currently available to us. Forward-looking statements include information concerning our possible or assumed future results of operations and expenses, business strategies and plans, trends, market sizing, competitive position, industry environment, potential growth opportunities and product capabilities, among other things. Forward-looking statements include all statements that are not historical facts and, in some cases, can be identified by terms such as “aim,” “anticipates,” “believes,” “could,” “estimates,” “expects,” “goal,” “intends,” “may,” “plans,” “potential,” “predicts,” “projects,” “strive,” “will,” “would” or similar expressions and the negatives of those terms.

Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements, including those described in “Risk Factors,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and elsewhere in this report. Given these uncertainties, you should not place undue reliance on these forward-looking statements.

Any forward-looking statement made by us in this report speaks only as of the date on which it is made. Except as required by law, we disclaim any obligation to update these forward-looking statements publicly, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future.

As used in this report, the terms “Veeva,” the “Company,” “Registrant,” “we,” “us,” and “our” mean Veeva Systems Inc. and it subsidiaries unless the context indicates otherwise.

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.
VEEVA SYSTEMS INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except number of shares and par value)

	July 31, 2018 (Unaudited)	January 31, 2018 *As adjusted
Assets		
Current assets:		
Cash and cash equivalents	$511,735	$320,183
Short-term investments	498,690	441,779
Accounts receivable, net of allowance for doubtful accounts of $461 and $345, respectively	111,795	224,668
Unbilled accounts receivable	14,777	13,348
Prepaid expenses and other current assets	15,361	12,443
Total current assets	1,152,358	1,012,421
Property and equipment, net	50,705	52,284
Deferred costs, net	28,126	30,306
Goodwill	95,804	95,804
Intangible assets, net	27,854	31,490
Deferred income taxes, noncurrent	3,468	2,222
Other long-term assets	6,277	5,806
Total assets	$1,364,592	$1,230,333
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$7,661	$6,944
Accrued compensation and benefits	14,113	17,054
Accrued expenses and other current liabilities	11,989	13,152
Income tax payable	1,725	2,080
Deferred revenue	259,170	266,939
Total current liabilities	294,658	306,169
Deferred income taxes, noncurrent	12,309	10,949
Other long-term liabilities	7,249	6,977
Total liabilities	314,216	324,095
Commitments and contingencies (Note 12)		
Stockholders' equity:		
Class A common stock, $0.00001 par value; 800,000,000 shares authorized,	1	1

121,412,763 and 117,246,735 issued and outstanding at July 31, 2018 and January 31, 2018, respectively		
Class B common stock, $0.00001 par value; 190,000,000 shares authorized, 22,731,725 and 24,822,661 issued and outstanding at July 31, 2018 and January 31, 2018, respectively	—	—
Additional paid-in capital	566,533	515,272
Accumulated other comprehensive income	(119)	1,600
Retained earnings	483,961	389,365
Total stockholders' equity	1,050,376	906,238
Total liabilities and stockholders' equity	$ 1,364,592	$ 1,230,333

See Notes to Condensed Consolidated Financial Statements.

*See note 1 of the notes to the condensed consolidated financial statements for a summary of adjustments.

Table of Contents

VEEVA SYSTEMS INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands, except per share data)

	Three months ended		Six months ended	
	July 31, 2018	2017 *As adjusted	July 31, 2018	2017 *As adjusted
	(Unaudited)			
Revenues:				
Subscription services	$169,592	$135,550	$325,595	$264,681
Professional services and other	40,017	32,245	79,561	62,886
Total revenues	209,609	167,795	405,156	327,567
Cost of revenues(1):				
Cost of subscription services	29,146	26,800	59,059	52,938
Cost of professional services and other	30,080	23,600	60,322	46,339
Total cost of revenues	59,226	50,400	119,381	99,277
Gross profit	150,383	117,395	285,775	228,290
Operating expenses(1):				
Research and development	38,826	32,678	76,023	60,989
Sales and marketing	38,222	32,070	72,607	62,211
General and administrative	20,517	14,580	40,371	28,160
Total operating expenses	97,565	79,328	189,001	151,360
Operating income	52,818	38,067	96,774	76,930
Other income, net	3,342	2,858	5,481	3,449
Income before income taxes	56,160	40,925	102,255	80,379
Provision for income taxes	5,874	2,323	7,659	4,781
Net income	$50,286	$38,602	$94,596	$75,598
Net income attributable to Class A and Class B common stockholders, basic and diluted	$50,286	$38,602	$94,596	$75,598
Net income per share attributable to Class A and Class B common stockholders:				
Basic	$0.35	$0.28	$0.66	$0.54
Diluted	$0.32	$0.25	$0.61	$0.49
Weighted-average shares used to compute net income per share attributable to Class A and Class B common stockholders:				
Basic	143,748	140,010	143,271	139,351
Diluted	155,416	153,778	155,227	153,301

Other comprehensive income:				
Net change in unrealized losses on available-for-sale investments	$357	$34	$662	$(72)
Net change in cumulative foreign currency translation gain (loss)	(1,572)	327	(2,381)	1,232
Comprehensive income	$49,071	$38,963	$92,877	$76,758

(1) Includes stock-based compensation as follows:

Cost of revenues:				
Cost of subscription services	$416	$376	$761	$718
Cost of professional services and other	2,657	2,133	4,985	3,822
Research and development	5,795	4,349	10,462	8,151
Sales and marketing	4,830	4,173	8,918	8,020
General and administrative	6,020	2,349	11,603	4,457
Total stock-based compensation	$19,718	$13,380	$36,729	$25,168

See Notes to Condensed Consolidated Financial Statements.

* See note 1 of the notes to the condensed consolidated financial statements for a summary of adjustments.

Table of Contents

VEEVA SYSTEMS INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Three months ended		Six months ended	
	July 31, 2018	2017 * As adjusted	July 31, 2018	2017 * As adjusted
	(Unaudited)			
Cash flows from operating activities				
Net income	$50,286	$38,602	$94,596	$75,598
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	3,498	3,571	7,094	7,020
Amortization of premiums (accretion of discount) on short-term investments	(353)	386	(532)	842
Stock-based compensation	19,718	13,380	36,729	25,168
Amortization of deferred costs	4,583	4,087	9,102	8,135
Deferred income taxes	868	(296)	818	(943)
(Gain) Loss on foreign currency from market-to-market derivative	(186)	204	(163)	253
Bad debt expense (recovery)	(58)	(198)	178	(206)
Changes in operating assets and liabilities:				
Accounts receivable	43,103	16,345	112,695	87,149
Unbilled accounts receivable	2,858	7,453	(1,429)	(479)
Deferred costs	(3,371)	(4,046)	(6,922)	(7,763)
Income taxes	1,992	483	(504)	(2,062)
Prepaid expenses and other current and long-term assets	(2,796)	331	(3,509)	(1,160)
Accounts payable	(1,443)	700	538	244
Accrued expenses and other current liabilities	(1,540)	(361)	(4,104)	544
Deferred revenue	(30,406)	(24,250)	(7,756)	5,161
Other long-term liabilities	60	1,215	567	2,266
Net cash provided by operating activities	86,813	57,606	237,398	199,767
Cash flows from investing activities				
Purchases of short-term investments	(181,069)	(87,202)	(374,231)	(143,451)
Maturities and sales of short-term investments	141,266	69,681	317,810	128,377
Purchases of property and equipment	(686)	(2,535)	(1,395)	(6,495)
Capitalized internal-use software development costs	(284)	(242)	(514)	(1,033)
Net cash used in investing activities	(40,773)	(20,298)	(58,330)	(22,602)
Cash flows from financing activities				

Proceeds from exercise of common stock options	7,022	6,131	14,861	13,416
Net cash provided by financing activities	7,022	6,131	14,861	13,416
Effect of exchange rate changes on cash, cash equivalents, and restricted cash	(1,565)	327	(2,376)	1,240
Net change in cash, cash equivalents, and restricted cash	51,497	43,766	191,553	191,821
Cash, cash equivalents, and restricted cash at beginning of period	461,443	366,662	321,387	218,607
Cash, cash equivalents, and restricted cash at end of period	$512,940	$410,428	$512,940	$410,428
Cash, cash equivalents, and restricted cash at end of period:				
Cash and cash equivalents	$511,735	$409,226	$511,735	$409,226
Restricted cash included in other long-term assets	1,205	1,202	1,205	1,202
Total cash, cash equivalents, and restricted cash at end of period	$512,940	$410,428	$512,940	$410,428
Supplemental disclosures of other cash flow information:				
Cash paid for income taxes, net of refunds	$6,455	$1,780	$10,571	$6,036
Excess tax benefits from employee stock plans	$9,347	$14,765	$19,026	$28,675
Non-cash investing and financing activities:				
Changes in accounts payable and accrued expenses related to property and equipment purchases	$80	$465	$179	$(121)
Vesting of early exercised stock options	$—	$—	$—	$1

See Notes to Condensed Consolidated Financial Statements.

*See note 1 of the notes to the condensed consolidated financial statements for a summary of adjustments.

VEEVA SYSTEMS INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Summary of Business and Significant Accounting Policies

Description of Business

Veeva is a leading provider of industry cloud solutions for the global life sciences industry. We were founded in 2007 on the premise that industry-specific cloud solutions could best address the operating challenges and regulatory requirements of life sciences companies. Our products are designed to meet the unique needs of our customers and their most strategic business functions—from research and development (R&D) to commercialization. Our products address a broad range of needs—including multichannel customer relationship management (CRM), content management, master data management, and data regarding healthcare professionals and organizations. Veeva is also offering its regulated content management solutions to a new set of customers in process and discrete manufacturing, consumer packaged goods, and highly regulated services industries. Our fiscal year end is January 31.

Principles of Consolidation and Basis of Presentation

These unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (GAAP) and applicable rules and regulations of the Securities and Exchange Commission (SEC) regarding interim financial reporting and include the accounts of our wholly-owned subsidiaries after elimination of intercompany accounts and transactions. Certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Therefore, these condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in Veeva’s Annual Report on Form 10-K for the fiscal year ended January 31, 2018, filed on March 29, 2018. Except for the accounting policies for revenue recognition, unbilled accounts receivable, and deferred costs that were updated as a result of adopting ASU 2014-09, “Revenue from Contracts with Customers” (Topic 606), there have been no changes to our significant accounting policies described in the annual report that have had a material impact on our condensed consolidated financial statements and related notes.

The condensed consolidated balance sheet as of January 31, 2018 included herein was derived from the audited financial statements as of that date. These unaudited condensed consolidated financial statements reflect all normal recurring adjustments necessary to present fairly the financial position, results of operations, our comprehensive income and cash flows for the interim periods, but are not necessarily indicative of the results of operations to be anticipated for the full fiscal year ending January 31, 2019 or any other period.

Effective February 1, 2018, we adopted the requirements of Topic 606, ASU 2016-18, “Statement of Cash Flows, Restricted Cash,” and ASU 2018-02, “Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income,” as discussed in this note. All amounts and disclosures set forth in this Form 10-Q for previously reported periods have also been updated to comply with the new standards, as indicated by the “as adjusted” tables in this footnote.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with GAAP requires us to make estimates, judgments and assumptions that affect the condensed consolidated financial statements and the notes thereto. These estimates are based on information available as of the date of the condensed consolidated financial statements. On a regular basis, management evaluates these estimates and assumptions. Significant items subject to such estimates and assumptions include, but are not limited to:

- the standalone selling price for each distinct performance obligation included in customer contracts with multiple performance obligations;
- the period of benefit for deferred costs;
- the collectibility of our accounts receivable;
- the fair value of assets acquired and liabilities assumed for business combinations;
- the valuation of short-term investments and the determination of other-than-temporary impairments;

Table of Contents

- the realizability of deferred income tax assets and liabilities;
- the fair value of our stock-based awards; and
- the capitalization and estimated useful life of internal-use software development costs.

As future events cannot be determined with precision, actual results could differ significantly from those estimates.

Revenue Recognition

We derive our revenues primarily from subscription services and professional services. Subscription services revenues consist of fees from customers accessing our cloud-based software solutions and subscription or license fees for our data solutions. Professional services and other revenues consist primarily of fees from implementation services, configuration, data services, training and managed services related to our solutions. Revenues are recognized when control of these services is transferred to our customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those services.

We determine revenue recognition through the following steps:

- Identification of the contract, or contracts, with a customer;
- Identification of the performance obligations in the contract;
- Determination of the transaction price;
- Allocation of the transaction price to the performance obligations in the contract; and
- Recognition of revenue when, or as, we satisfy a performance obligation.

Our subscription services agreements are generally non-cancelable during the term, although customers typically have the right to terminate their agreements for cause in the event of material breach.

Subscription Services Revenues

Subscription services revenues are recognized ratably over the respective non-cancelable subscription term because of the continuous transfer of control to the customer. Our subscription arrangements are considered service contracts, and the customer does not have the right to take possession of the software.

Professional Services and Other Revenues

The majority of our professional services arrangements are recognized on a time and materials basis. Professional services revenues recognized on a time and materials basis are measured monthly based on time incurred and contractually agreed upon rates. Certain professional services revenues are based on fixed fee arrangements and revenues are recognized as services are rendered. Data services and training revenues are generally recognized as the services are performed.

Contracts with Multiple Performance Obligations

Some of our contracts with customers contain multiple performance obligations. For these contracts, we account for individual performance obligations separately when they are distinct. The transaction price is allocated to the separate performance obligations on a relative standalone selling price basis. We determine the standalone selling prices based on our overall pricing objectives, taking into consideration market conditions and other factors, including other groupings such as customer type and geography.

Unbilled Accounts Receivable

Unbilled accounts receivable is a contract asset related to the delivery of our subscription services and professional services for which the related billings will occur in a future period. Unbilled accounts receivable consists of (i) revenue recognized for professional services performed but not yet billed and (ii) revenue recognized from non-cancelable, multi-year orders in which fees increase annually but for which we are not contractually able to invoice until a future period.

Deferred Costs

Deferred costs include sales commissions associated with obtaining a contract with a customer. These costs are deferred and then amortized over a period of benefit that we have determined to be three years. We determined the period of benefit by taking into consideration our customer contracts, our technology and other factors. Amortization expense is included in sales and marketing expenses in the accompanying condensed consolidated statements of operations.

Deferred Revenue

Deferred revenue includes amounts billed to customers for which the revenue recognition criteria have not been met. Deferred revenue primarily consists of billings or payments received in advance of revenue recognition from our subscription services and, to a lesser extent, professional services and other revenues described above. Deferred revenue is recognized as we satisfy our performance obligations. We generally invoice our customers in annual or quarterly installments for subscription services. Accordingly, the deferred revenue balance does not generally represent the total contract value of a subscription arrangement. Deferred revenue that will be recognized during the succeeding 12-month period is recorded as current deferred revenue and the remaining portion is recorded as noncurrent, which is included in other long-term liabilities on the condensed consolidated balance sheet.

Certain Risks and Concentrations of Credit Risk

Our revenues are derived from subscription services, professional services and other services delivered primarily to the life sciences industry. We operate in markets that are highly competitive and rapidly changing. Significant technological changes, shifting customer needs, the emergence of competitive products or services with new capabilities and other factors could negatively impact our operating results.

Our financial instruments that potentially subject us to concentration of credit risk consist primarily of cash and cash equivalents, short-term investments and trade accounts receivable. Our cash equivalents and short-term investments are held by established financial institutions. We have established guidelines relative to credit ratings, diversification and maturities that seek to maintain safety and liquidity. Deposits in these financial institutions may significantly exceed federally insured limits.

We do not require collateral from our customers and generally require payment within 30 to 60 days of billing. We periodically evaluate the collectibility of our accounts receivable and provide an allowance for doubtful accounts as necessary, based on historical experience. Historically, losses related to lack of collectibility have not been material.

The following customers individually exceeded 10% of total accounts receivable as of the dates shown:

	July 31, 2018	January 31, 2018
Customer 1	*	18%
Customer 2	*	13%

*Does not exceed 10%.

No single customer represented over 10% of total revenues in the condensed consolidated statements of comprehensive income for the three and six months ended July 31, 2018 and 2017.

Table of Contents

New Accounting Pronouncements Adopted in Fiscal 2019

Income Taxes

In March 2018, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2018-05, “Income Taxes (Topic 740): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118.” This standard amends ASC 740, Income Taxes, to provide accounting guidance for the tax effects of the Tax Act pursuant to Staff Accounting Bulletin No. 118, which allows companies to complete the accounting under ASC 740 within a one-year measurement period from the Tax Act enactment date. This standard is effective upon issuance. We have applied the guidance in ASU 2018-05 (see note 8 of the notes to our condensed consolidated financial statements).

Stranded Tax Effects in Accumulated Other Comprehensive Income

In February 2018, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2018-02, "Income Statement-Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income." This update allows reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act of 2017 (Tax Act).

ASU 2018-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those years. We early adopted this standard effective February 1, 2018. The impact on our condensed consolidated financial statements was immaterial.

Restricted Cash

In November 2016, the FASB issued ASU 2016-18, “Statement of Cash, Restricted Cash,” which requires that amounts generally described as restricted cash or restricted cash equivalents be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. This standard is effective for our interim and annual reporting periods beginning after December 15, 2017. We adopted ASU 2016-18 retrospectively, effective February 1, 2018. As a result of including restricted cash with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts presented on the condensed consolidated statement of cash flows, the impact on net cash flows for the three and six months ended July 31, 2018 was immaterial.

Financial Instruments

In January 2016, the FASB issued ASU 2016-01, “Financial Instruments.” ASU 2016-01, among other things, requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income and clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity’s other deferred tax assets. This standard is effective for our interim and annual reporting periods beginning after December 15, 2017. We adopted ASU 2016-01 effective February 1, 2018. There was no impact to our condensed consolidated financial statements.

Revenue Recognition

In May 2014, the FASB issued Topic 606. This guidance outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the revenue model requires revenue to be recognized 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 supersedes the existing revenue recognition guidance in “Revenue Recognition (Topic 605)”.

We have adopted the requirements of the new standard as of February 1, 2018, utilizing the full retrospective transition method. Adoption of the new standard resulted in changes to our accounting policies for revenue recognition, unbilled accounts receivable, and deferred costs as detailed above in our description of Revenue Recognition. We applied a practical expedient provided by the new standard and are not disclosing the amount of consideration allocated to the remaining performance obligations for all reporting periods presented before the date of the initial application.

Table of Contents

The impact of adoption included the deferral of costs to obtain customer contracts, which is comprised of commissions on our subscription services arrangements. Such costs were expensed as incurred under Topic 605, whereas under Topic 606, they are generally capitalized and amortized over the costs' associated term of economic benefit. We have determined that the term of economic benefit of our costs to obtain customer contracts is three years.

Revenue for the majority of our subscription services customer contracts will continue to be recognized over time because of the continuous transfer of control to the customer; however, there is some impact to revenue primarily driven by (i) accounting for non-cancelable multi-year contracts, (ii) the removal of the current limitation on contingent revenue, which may result in revenue being recognized earlier for certain contracts, and (iii) allocation of revenue from subscription services to professional services.

We adjusted our condensed consolidated financial statements from amounts previously reported to reflect the adoption of Topic 606, ASU 2016-18, or ASU 2018-02. Select impacted condensed consolidated balance sheet line items, which reflect the adoption of the new standards are as follows (in thousands):

	January 31, 2018			
	As Reported	Adjustments		As adjusted
Assets				
Accounts receivable[1]	$233,731	(9,063)	a	$224,668
Unbilled accounts receivable[1]	—	13,348	a	13,348
Deferred costs, net	—	30,306	a	30,306
Deferred income taxes, non-current	3,490	(1,268)	a	2,222
Liabilities				
Deferred revenue	$275,446	$ (8,507)	a	$266,939
Deferred income taxes, non-current	3,828	7,121	a	10,949
Stockholders' equity:				
Accumulated other comprehensive income	$1,404	$ 196	b	$1,600
Retained earnings	354,850	34,515	a, b	389,365

(1) Unbilled accounts receivable was previously included in Accounts receivable before the adoption of Topic 606.
a Adjusted to reflect the adoption of ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)."

b Adjusted to reflect the adoption of ASU 2018-02, "Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income."

Select unaudited condensed consolidated statement of comprehensive income line items, which reflect the adoption of the new standards are as follows (in thousands):

	Three months ended July 31, 2017		
	As Reported	Adjustments	As adjusted
Revenues:			
Subscription services	$134,340	$ 1,210	a $135,550
Operating expenses:			
Sales and marketing	32,017	53	a 32,070
Operating income	36,898	1,169	a 38,067
Provision for income taxes	1,912	411	a 2,323
Net income	$37,844	$ 758	a $38,602
Net income per share attributable to Class A and Class B common stockholders:			
Basic	$0.27	$ 0.01	a $0.28
Diluted	$0.25	$ —	a $0.25

Table of Contents

	Six months ended July 31, 2017			
	As Reported	Adjustments		As adjusted
Revenues:				
Subscription services	$261,617	$ 3,064	a	$264,681
Operating expenses:				
Sales and marketing	61,827	384	a	62,211
Operating income	74,237	2,693	a	76,930
Provision for income taxes	3,819	962	a	4,781
Net income	$73,867	$ 1,731	a	$75,598
Net income per share attributable to Class A and Class B common stockholders:				
Basic	$0.53	$ 0.01	a	$0.54
Diluted	$0.48	$ 0.01	a	$0.49

a Adjusted to reflect the adoption of ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)."

Select unaudited condensed consolidated statement of cash flows line items, which reflect the adoption of the new standards are as follows (in thousands):

	Three months ended July 31, 2017			
	As Reported	Adjustments		As adjusted
Cash flows from operating activities				
Net income	$37,844	$ 758	a	$38,602
Adjustments to reconcile net income to net cash provided by operating activities:				
Amortization of deferred costs	—	4,087	a	4,087
Changes in operating assets and liabilities:				
Accounts receivable	16,169	176	a	16,345
Unbilled accounts receivable	—	7,453	a	7,453
Deferred costs	—	(4,046)	a	(4,046)
Deferred revenue	(15,410)	(8,840)	a	(24,250)
Net cash provided by operating activities	57,607	(1)	a	57,606

Change in restricted cash and deposits	(201)	201	b	—
Net cash (used in) provided by investing activities	(20,499)	201	b	(20,298)
Net change in cash, cash equivalents and restricted cash	43,566	200	b	43,766
Cash, cash equivalents and restricted cash at the beginning of period	365,660	1,002	b	366,662
Cash, cash equivalents and restricted cash at the end of period	$409,226	$ 1,202	b	$410,428

	Six months ended July 31, 2017			
	As Reported	Adjustments		As adjusted
Cash flows from operating activities				
Net income	$73,867	$ 1,731	a	$75,598
Adjustments to reconcile net income to net cash provided by operating activities:				
Amortization of deferred costs	—	8,135	a	8,135
Changes in operating assets and liabilities:				
Accounts receivable	85,869	1,280	a	87,149
Unbilled accounts receivable	—	(479)	a	(479)
Deferred costs	—	(7,763)	a	(7,763)
Deferred revenue	9,027	(3,866)	a	5,161
Net cash provided by operating activities	199,768	(1)	a	199,767
Change in restricted cash and deposits	(202)	202	b	—
Net cash (used in) provided by investing activities	(22,804)	202	b	(22,602)
Net change in cash, cash equivalents and restricted cash	191,620	201	b	191,821
Cash, cash equivalents and restricted cash at the beginning of period	217,606	1,001	b	218,607
Cash, cash equivalents and restricted cash at the end of period	$409,226	$ 1,202	b	$410,428

a Adjusted to reflect the adoption of ASU 2014-09, “Revenue from Contracts with Customers (Topic 606).”

b Adjusted to reflect the adoption of ASU 2016-18, “Statement of Cash Flows, Restricted Cash.”

Future periods may or may not have the same impact as those set forth above.

Table of Contents

Note 2. Short-Term Investments

At July 31, 2018, short-term investments consisted of the following (in thousands):

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Available-for-sale securities:				
Certificates of deposits	$ 11,036	$ 7	$ —	$ 11,043
Asset-backed securities	86,498	2	(555)	85,945
Commercial paper	13,596	2	(1)	13,597
Corporate notes and bonds	152,185	56	(718)	151,523
Foreign government bonds	2,999	—	(21)	2,978
Mortgage backed securities	13,366	—	(81)	13,285
U.S. agency obligations	57,657	2	(25)	57,634
U.S. treasury securities	162,888	1	(204)	162,685
Total available-for-sale securities	$ 500,225	$ 70	$ (1,605)	$ 498,690

At January 31, 2018, short-term investments consisted of the following (in thousands):

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
Available-for-sale securities:				
Asset-backed securities	$ 67,875	$ —	$ (424)	$ 67,451
Commercial paper	19,926	—	(12)	19,914
Corporate notes and bonds	160,499	1	(759)	159,741
Foreign government bonds	1,504	—	(18)	1,486
Mortgage backed securities	11,555	—	(75)	11,480
U.S. agency obligations	71,206	1	(76)	71,131
U.S. treasury securities	110,707	5	(136)	110,576
Total available-for-sale securities	$ 443,272	$ 7	$ (1,500)	$ 441,779

The following table summarizes the estimated fair value of our short-term investments, designated as available-for-sale and classified by the contractual maturity date of the securities as of the dates shown (in thousands):

	July 31, 2018	January 31, 2018
Due in one year or less	$331,500	$308,172
Due in greater than one year	167,190	133,607
Total	$498,690	$441,779

We have certain available-for-sale securities in a gross unrealized loss position, some of which have been in that position for more than 12 months. We review our debt securities classified as short-term investments on a regular basis to evaluate whether or not any security has experienced an other-than-temporary decline in fair value. We consider factors such as the length of time and extent to which the market value has been less than the cost, our financial position and near-term prospects and our intent to sell, or whether it is more likely than not we will be required to sell the investment before recovery of the investment's amortized-cost basis. If we determine that an other-than-temporary decline exists in one of these securities, we would write down the respective investment to fair value. For debt securities, the portion of the write-down related to credit loss would be recognized as other income, net in our condensed consolidated statements of comprehensive income. Any portion not related to credit loss would be included in accumulated other comprehensive income. There were no impairments considered other-than-temporary as of July 31, 2018 and January 31, 2018.

Table of Contents

The following table shows the fair values and the gross unrealized losses of these available-for-sale securities aggregated by investment category as of July 31, 2018 (in thousands):

	Fair value	Gross unrealized losses
Asset-backed securities	$82,019	$ (555)
Commercial paper	3,892	(1)
Corporate notes and bonds	108,287	(718)
Foreign government bonds	2,979	(21)
Mortgage backed securities	13,285	(81)
U.S. agency obligations	49,893	(25)
U.S. treasury securities	153,505	(204)

The following table shows the fair values and the gross unrealized losses of these available-for-sale securities aggregated by investment category as of January 31, 2018 (in thousands):

	Fair value	Gross unrealized losses
Asset-backed securities	$65,690	$ (424)
Commercial paper	19,914	(12)
Corporate notes and bonds	155,419	(759)
Foreign government bonds	1,485	(18)
Mortgage backed securities	11,481	(75)
U.S. agency obligations	66,655	(76)
U.S. treasury securities	82,147	(136)

Note 3. Deferred Costs

Deferred costs, which consist of deferred sales commissions, were $28.1 million and $30.3 million as of July 31, 2018 and January 31, 2018, respectively. For the three and six months ended July 31, 2018, amortization expense for the deferred costs was $4.6 million and $9.1 million, respectively. For the three and six months ended July 31, 2017, amortization expense for the deferred costs was $4.1 million and $8.1 million, respectively. There has been no impairment loss recorded in relation to the costs capitalized for all periods presented.

Note 4. Property and Equipment, Net

Property and equipment, net consists of the following as of the dates shown (in thousands):

	July 31, 2018	January 31, 2018
Land	$3,040	$3,040
Building	20,984	20,984
Land improvements and building improvements	20,172	20,073
Equipment and computers	7,837	7,732
Furniture and fixtures	9,495	9,619
Leasehold improvements	3,613	3,637
Construction in progress	270	36
	65,411	65,121
Less accumulated depreciation	(14,706)	(12,837)
Total property and equipment, net	$50,705	$52,284

Total depreciation expense was $1.6 million and $3.2 million for the three and six months ended July 31, 2018, respectively, and $1.4 million and $2.7 million for the three and six months ended July 31, 2017, respectively. Land is not depreciated.

Table of Contents

Note 5. Intangible Assets

The following schedule presents the details of intangible assets as of July 31, 2018 (dollar amounts in thousands):

	July 31, 2018			
	Gross carrying amount	Accumulated amortization	Net	Remaining useful life (in years)
Existing technology	$3,880	$ (3,813)	$67	1.7
Database	4,939	(4,340)	599	1.7
Customer contracts and relationships	33,643	(10,560)	23,083	7.1
Software	10,867	(6,979)	3,888	1.7
Brand	1,141	(924)	217	0.7
	$54,470	$ (26,616)	$27,854	

The following schedule presents the details of intangible assets as of January 31, 2018 (dollar amounts in thousands):

	January 31, 2018			
	Gross carrying amount	Accumulated amortization	Net	Remaining useful life (in years)
Existing technology	$3,880	$ (3,509)	$371	0.8
Database	4,939	(4,091)	848	2.0
Customer contracts and relationships	33,643	(8,798)	24,845	7.5
Software	10,867	(5,820)	5,047	2.2
Brand	1,141	(762)	379	1.2
	$54,470	$ (22,980)	$31,490	

Amortization expense associated with intangible assets was $1.8 million and $3.6 million for the three and six months ended July 31, 2018, respectively, and $2.0 million and $4.0 million for the three and six months ended July 31, 2017, respectively.

The estimated amortization expense for intangible assets, for the next five years and thereafter is as follows as of July 31, 2018 (in thousands):

Period	Estimated amortization expense
Fiscal 2019	$ 3,334
Fiscal 2020	6,062
Fiscal 2021	3,629
Fiscal 2022	3,182
Fiscal 2023	3,182
Thereafter	8,465
Total	$ 27,854

Table of Contents

Note 6. Accrued Expenses

Accrued expenses consisted of the following as of the dates shown (in thousands):

	July 31, 2018	January 31, 2018
Accrued commissions	$1,357	$3,565
Accrued bonus	2,504	3,068
Deferred compensation associated with Zinc Ahead	464	467
Accrued vacation	3,571	2,608
Payroll tax payable	3,020	3,580
Accrued other compensation and benefits	3,197	3,766
Total accrued compensation and benefits	$14,113	$17,054
Accrued fees payable to salesforce.com	4,990	4,929
Accrued third-party professional services subcontractors' fees	996	1,614
Taxes payable	2,435	3,009
Other accrued expenses	3,568	3,600
Total accrued expenses and other current liabilities	$11,989	$13,152

Note 7. Fair Value Measurements

The carrying amounts of accounts receivable and other current assets, accounts payable and accrued liabilities approximate their fair value due to their short-term nature.

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

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

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

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

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

Table of Contents

The following table presents the fair value hierarchy for financial assets measured at fair value on a recurring basis as of July 31, 2018 (in thousands):

	Level 1	Level 2	Level 3	Total
Assets				
Cash equivalents:				
Money market funds	$66,114	$—	$ —	$66,114
Commercial paper	—	4,485	—	4,485
Corporate notes and bonds	—	3,034	—	3,034
U.S. agency obligations	—	11,128	—	11,128
U.S. treasury securities	—	29,967	—	29,967
Short-term investments:				
Certificates of deposits	—	11,043	—	11,043
Asset-backed securities	—	85,945	—	85,945
Commercial paper	—	13,597	—	13,597
Corporate notes and bonds	—	151,523	—	151,523
Foreign government bonds	—	2,978	—	2,978
Mortgage backed securities	—	13,285	—	13,285
U.S. agency obligations	—	57,634	—	57,634
U.S. treasury securities	—	162,685	—	162,685
Foreign currency derivative contracts	—	59	—	59
Total	$66,114	$547,363	$ —	$613,477
Liabilities				
Foreign currency derivative contracts	—	160	—	160
Total	$—	$160	$ —	$160

The following table presents the fair value hierarchy for financial assets measured at fair value on a recurring basis as of January 31, 2018 (in thousands):

	Level 1	Level 2	Level 3	Total
Assets				
Cash equivalents:				
Money market funds	$25,820	$—	$ —	$25,820
Commercial paper	—	1,999	—	1,999
Corporate notes and bonds	—	2,080	—	2,080
U.S. treasury securities	—	8,000	—	8,000
Short-term investments:				
Asset-backed securities	—	67,451	—	67,451
Commercial paper	—	19,914	—	19,914

Corporate notes and bonds	—	159,741	—	159,741
Foreign government bonds	—	1,486	—	1,486
Mortgage backed securities	—	11,480	—	11,480
U.S. agency obligations	—	71,131	—	71,131
U.S. treasury securities	—	110,576	—	110,576
Foreign currency derivative contracts	—	127	—	127
Total	$25,820	$453,985	$ —	$479,805
Liabilities				
Foreign currency derivative contracts	—	391	—	391
Total	$—	$391	$ —	$391

We determine the fair value of our security holdings based on pricing from our service providers and market prices from industry-standard independent data providers. The valuation techniques used to measure the fair value of financial instruments having Level 2 inputs were derived from non-binding consensus prices that are corroborated by observable market data or quoted market prices for similar instruments. Such market prices may be quoted prices in active markets for identical assets (Level 1 inputs) or pricing determined using inputs other than quoted prices that are observable either directly or indirectly (Level 2 inputs). We perform procedures to ensure that appropriate fair values are recorded such as comparing prices obtained from other sources.

Table of Contents

Balance Sheet Hedges

During the three months ended July 31, 2018, we entered into foreign currency forward contracts (the "Forward Contracts") in order to hedge our foreign currency exposure. A Forward Contract is a commitment to deliver a certain amount of currency at a certain price on a specific date in the future. By entering into Forward Contracts and holding them to maturity, we are locked into a future currency exchange rate in an amount equal to and for the terms of the Forward Contracts. We account for derivative instruments at fair value with changes in the fair value recorded as a component of other income, net in our condensed consolidated statements of comprehensive income. Cash flows from such forward contracts are classified as operating activities. We recognized realized foreign currency losses of $0.2 million and gains of $0.3 million during the three and six months ended July 31, 2018 on hedging, respectively, and losses of $2.2 million and $2.8 million during the three and six months ended July 31, 2017 on hedging, respectively.

The fair value of our outstanding derivative instruments is summarized below (in thousands):

	July 31, 2018	January 31, 2018
Notional amount of foreign currency derivative contracts	$2,946	$36,266
Fair value of foreign currency derivative contracts	3,047	36,531

Details on outstanding balance sheet hedges are presented below as of the date shown below (in thousands):

		July 31, 2018	January 31, 2018
Derivative Assets	Balance Sheet Location		
Derivatives not designated as hedging instruments:			
Foreign currency derivative contracts	Prepaid expenses and other current assets	$59	$ 127
Derivative Liabilities			
Derivatives not designated as hedging instruments:			
Foreign currency derivative contracts	Accrued expenses	$160	$ 391

Note 8. Income Taxes

For the three months ended July 31, 2018 and 2017, our effective tax rates were 10.5% and 5.7%, respectively. During the three months ended July 31, 2018 as compared to the prior year period, our effective tax rate increased primarily due to a decrease in excess tax benefits, which was partially offset by a reduced federal tax rate as a result of the Tax Act. We recognized excess tax benefits in our provision for income taxes of $9.3 million and $14.8 million for the three months ended July 31, 2018 and 2017, respectively.

For the six months ended July 31, 2018 and 2017, our effective tax rates were 7.5% and 5.9%, respectively. During the six months ended July 31, 2018 as compared to the prior year period, our effective tax rate increased primarily due to a decrease in excess tax benefits, which was partially offset by a reduced federal tax rate as a result of the Tax Act. We recognized excess tax benefits in our provision for income taxes of $19.0 million and $28.7 million for the six months ended July 31, 2018 and 2017, respectively.

On May 1, 2018 the Internal Revenue Service (IRS) issued a closing audit notice related to the income tax return for fiscal year ended January 31, 2015. The completion of the IRS audit resulted in an immaterial impact to our financial statements.

The SEC staff issued Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act (SAB 118), which allows companies the ability to record provisional amounts during a measurement period not to extend more than one year beyond the Tax Act enactment date. Since the Tax Act was passed late in 2017 and further guidance and accounting interpretations are expected during the measurement period, our provisional estimate on the effect of the Tax Act in our financial statements remains subject to change. We have not made any material changes to our provisional estimates from the prior period.

Table of Contents

Note 9. Deferred Revenue and Performance Obligations

We recognized $135.2 million and $187.9 million of subscription services revenue during the three and six months ended July 31, 2018, respectively, and $105.0 million and $146.5 million during the three and six months ended July 31, 2017, respectively, that was included in the deferred revenue balances at the beginning of the respective periods. Professional services revenue recognized in the same periods from deferred revenue balances at the beginning of the respective periods was immaterial.

Transaction Price Allocated to the Remaining Performance Obligations

Transaction price allocated to the remaining performance obligations represents contracted revenue that has not yet been recognized, which includes deferred revenue and non-cancelable amounts that will be invoiced and recognized as revenues in future periods. We applied the practical expedient in accordance with Topic 606 to exclude the amounts related to professional services contracts that are on a time-and-material basis. Revenue from remaining performance obligations for professional services contracts as of July 31, 2018 was immaterial.

As of July 31, 2018, approximately $452.9 million of revenue is expected to be recognized from remaining performance obligations for subscription services contracts. We expect to recognize revenue on approximately $342.0 million of these remaining performance obligations over the next 12 months, with the balance recognized thereafter.

Note 10. Stockholders' Equity

Stock Option Activity

A summary of stock option activity for the six months ended July 31, 2018 is as follows:

	Number of shares	Weighted average exercise price	Weighted average remaining contractual term (in years)	Aggregate intrinsic value
Options outstanding at January 31, 2018	16,024,146	$ 16.76	6.1	$738,648,507
Options granted	175,000	77.88		
Options exercised	(1,412,949)	10.17		
Options forfeited/cancelled	(202,268)	8.53		
Options outstanding at July 31, 2018	14,583,929	$ 18.25	5.8	$837,197,633
Options vested and exercisable at July 31, 2018	6,444,160	$ 5.18	4.5	$453,984,350
Options vested and exercisable at July 31, 2018 and expected to vest thereafter	14,583,929	$ 18.25	5.8	$837,197,633

During the six months ended July 31, 2018, we granted 175,000 stock options under the 2013 Equity Incentive Plan (EIP). The weighted average grant-date fair value of options granted was $35.04 for the six months ended July 31,

2018. We did not grant any stock options during the three months ended July 31, 2018.

As of July 31, 2018, there was $106.9 million in unrecognized compensation cost related to unvested stock options granted under the 2007 Stock Plan (2007 Plan), 2012 Equity Incentive Plan and 2013 EIP. This cost is expected to be recognized over a weighted average period of 3.9 years.

As of July 31, 2018, we had authorized and unissued shares of common stock sufficient to satisfy exercises of stock options.

The total intrinsic value of options exercised was approximately $42.9 million and $91.3 million for the three and six months ended July 31, 2018.

Table of Contents

Restricted Stock Units

A summary of restricted stock unit (RSU) activity for the six months ended July 31, 2018 is as follows:

	Unreleased restricted stock units	Weighted average grant date fair value
Balance at January 31, 2018	2,901,736	$ 38.14
RSUs granted	832,014	72.02
RSUs vested	(662,087)	36.17
RSUs forfeited/cancelled	(156,241)	43.95
Balance at July 31, 2018	2,915,422	$ 47.95

During the three and six months ended July 31, 2018, we granted 194,304 and 832,014 RSUs under the 2013 EIP with a weighted-average grant date fair value of $78.85 and $72.02, respectively.

As of July 31, 2018, there was a total of $131.3 million in unrecognized compensation cost related to unvested RSUs. This cost is expected to be recognized over a weighted-average period of approximately 2.5 years.

Stock-Based Compensation

Compensation expense related to share-based transactions, including equity awards to employees and non-employee directors, is measured and recognized in the condensed consolidated financial statements based on fair value. The grant date fair value of each option award is estimated on the grant date using the Monte Carlo simulation or Black-Scholes option-pricing model. The stock-based compensation expense is recognized using a straight-line basis over the requisite service periods of the awards, which is generally four to nine years. For RSUs, the grant date fair value is based on the closing price of our common stock on the grant date.

Our option-pricing model requires the input of subjective assumptions, including the fair value of the underlying common stock, the expected term of the option, the expected volatility of the price of our common stock, risk-free interest rates, and the expected dividend yield of our common stock. The assumptions used in our option-pricing model represent management’s best estimates. These estimates involve inherent uncertainties and the application of management’s judgment. If factors change and different assumptions are used, our stock-based compensation expense could be materially different in the future.

The following table presents the weighted-average assumptions used to estimate the grant date fair value of options granted during the periods presented:

	Three Months Ended July 31,	Six Months Ended July 31,

	2018[1]	2017	2018	2017
Volatility	—%	43%	41%	43% – 44%
Expected term (in years)	—	6.35	6.35	6.35
Risk-free interest rate	—%	1.89%	2.73%	1.89% – 2.17%
Dividend yield	—%	—%	—%	—%

[1]Note that we did not grant any stock options during the three months ended July 31, 2018.

For the three and six months ended July 31, 2018 and 2017, we capitalized an immaterial amount of stock-based compensation as part of our internal-use software capitalization.

Note 11. Net Income per Share Attributable to Common Stockholders

We compute net income per share of our Class A and Class B common stock using the two-class method required for participating securities. We consider unvested shares issued upon the early exercise of options to be participating securities as the holders of these shares have a non-forfeitable right to dividends in the event of our declaration of a dividend for common shares.

Table of Contents

Under the two-class method, net income attributable to common stockholders is determined by allocating undistributed earnings, calculated as net income, less earnings attributable to participating securities.

The net income per share attributable to common stockholders is allocated based on the contractual participation rights of the Class A common stock and Class B common stock as if the income for the year has been distributed. As the liquidation and dividend rights are identical, the net loss attributable to common stockholders is allocated on a proportionate basis.

Basic net income per share of common stock is computed by dividing the net income attributable to common stockholders by the weighted-average number of shares of common stock outstanding during the period. All participating securities are excluded from the basic weighted-average shares of common stock outstanding. Unvested shares of common stock resulting from the early exercises of stock options are excluded from the calculation of the weighted-average shares of common stock until they vest as they are subject to repurchase until they are vested. The unvested shares of common stock resulting from early exercises of stock options accounted for all of our participating securities.

Diluted net income per share attributable to common stockholders is computed by dividing net income attributable to common stockholders by the weighted-average shares outstanding, including potentially dilutive shares of common equivalents outstanding during the period. The dilutive effect of potential shares of common stock are determined using the treasury stock method.

Undistributed net income for a given period is apportioned to participating securities based on the weighted-average shares of each class of common stock outstanding during the applicable period as a percentage of the total weighted-average shares outstanding during the same period.

For purposes of the diluted net income per share attributable to common stockholders calculation, unvested shares of common stock resulting from the early exercises of stock options and unvested options to purchase common stock are considered to be potentially dilutive shares of common stock. In addition, the computation of the fully diluted net income per share of Class A common stock assumes the conversion from Class B common stock, while the fully diluted net income per share of Class B common stock does not assume the conversion of those shares.

Table of Contents

The numerators and denominators of the basic and diluted EPS computations for our common stock are calculated as follows (in thousands, except per share data):

	Three Months Ended July 31,				Six Months Ended July 31,			
	2018		2017 *As adjusted		2018		2017 *As adjusted	
	Class A	Class B	Class A	Class B	Class A	Class B	Class A	Class B
Basic								
Numerator								
Net income	$42,326	$7,960	$30,820	$7,782	$79,137	$15,459	$59,243	$16,355
Undistributed earnings allocated to participating securities	—	—	—	—	—	—	—	—
Net income attributable to common stockholders, basic	$42,326	$7,960	$30,820	$7,782	$79,137	$15,459	$59,243	$16,355
Denominator								
Weighted average shares used in computing net income per share attributable to common stockholders, basic	120,994	22,754	111,786	28,224	119,857	23,414	109,204	30,147
Net income per share attributable to common stockholders, basic	$0.35	$0.35	$0.28	$0.28	$0.66	$0.66	$0.54	$0.54
Diluted								
Numerator								
Net income attributable to common stockholders, basic	$42,326	$7,960	$30,820	$7,782	$79,137	$15,459	$59,243	$16,355
Reallocation as a result of conversion of Class B to Class A common stock:								
Net income attributable to common stockholders, basic	7,960	—	7,782	—	15,459	—	16,355	—
Reallocation of net income to	—	3,177	—	2,759	—	6,096	—	5,391

Class B common stock								
Net income attributable to common stockholders, diluted	$50,286	$11,137	$38,602	$10,541	$94,596	$21,555	$75,598	$21,746
Denominator								
Number of shares used for basic EPS computation	120,994	22,754	111,786	28,224	119,857	23,414	109,204	30,147
Conversion of Class B to Class A common stock	22,754	—	28,224	—	23,414	—	30,147	—
Effect of potentially dilutive common shares	11,668	11,668	13,768	13,768	11,956	11,956	13,950	13,950
Weighted average shares used in computing net income per share attributable to common stockholders, diluted	155,416	34,422	153,778	41,992	155,227	35,370	153,301	44,097
Net income per share attributable to common stockholders, diluted	$0.32	$0.32	$0.25	$0.25	$0.61	$0.61	$0.49	$0.49

* See note 1 of the notes to the condensed consolidated financial statements for a summary of adjustments.

Potential common share equivalents excluded where the inclusion would be anti-dilutive are as follows:

	Three Months Ended July 31,		Six Months Ended July 31,	
	2018	2017	2018	2017
Options and awards to purchase shares not included in the computation of diluted net income per share because their inclusion would be anti-dilutive	3,157,436	337,503	3,123,695	558,126

Table of Contents

Note 12. Commitments and Contingencies

Litigation

IQVIA Litigation Matter.

On January 10, 2017, IQVIA Inc. (formerly Quintiles IMS Incorporated) and IMS Software Services, Ltd. (collectively, "IQVIA") filed a complaint against us in the U.S. District Court for the District of New Jersey (IQVIA Inc. v. Veeva Systems Inc. (No. 2:17-cv-00177)). In the complaint, IQVIA alleges that we have used unauthorized access to proprietary IQVIA data to improve our software and data products, and that our software is designed to steal IQVIA trade secrets. IQVIA further alleges that we have intentionally gained unauthorized access to IQVIA proprietary information to gain an unfair advantage in marketing our products and that we have made false statements concerning IQVIA's conduct and our data security capabilities. IQVIA asserts claims under both federal and state misappropriation of trade secret laws, federal false advertising law, and common law claims for unjust enrichment, tortious interference, and unfair trade practices. The complaint seeks declaratory and injunctive relief and unspecified monetary damages.

There are no dispositive motions pending with respect to IQVIA's claims against Veeva.

On March 13, 2017, we filed our answer and counterclaims in the IQVIA action. Our counterclaims allege that IQVIA has abused monopoly power as the dominant provider of data products for life sciences companies to exclude Veeva OpenData and Veeva Network from their respective markets. The counterclaims allege that IQVIA has engaged in various tactics to prevent customers from using our applications and has deliberately raised costs and difficulty for customers attempting to switch from IQVIA to our data products. The counterclaims assert federal and state antitrust claims, as well as claims under California's Unfair Practices Act and common law claims for intentional interference with contractual relations and intentional interference with prospective economic advantage. The counterclaims seek injunctive relief, monetary damages exceeding $200 million, and attorneys' fees.

On May 3, 2017, in lieu of filing an answer, IQVIA filed a motion to dismiss our counterclaims. The court has not yet ruled on that motion.

Discovery in the IQVIA litigation is currently in process and no trial date has been set. While it is not possible at this time to predict with any degree of certainty the ultimate outcome of this action, and we are unable to make a meaningful estimate of the amount or range of loss, if any, that could result from any unfavorable outcome, we believe that IQVIA's claims lack merit.

Medidata Litigation Matter.

On January 26, 2017, Medidata Solutions, Inc. filed a complaint in the U.S. District Court for the Southern District of New York (Medidata Solutions, Inc. v. Veeva Systems Inc. et al. (No. 1:17-cv-00589)) against us and five individual Veeva employees who previously worked for Medidata ("Individual Employees"). The complaint alleged that we induced and conspired with the Individual Employees to breach their employment agreements, including non-compete and confidentiality provisions, and to misappropriate Medidata's confidential and trade secret information. The complaint sought declaratory and injunctive relief, unspecified monetary damages, and attorneys' fees. Medidata has since amended its complaint twice, asserting the same claims with additional factual allegations, and has voluntarily dismissed the Individual Defendants without prejudice.

Veeva filed a motion to compel the entire matter to arbitration, which the district court denied, and we have appealed the district court's order to the U.S. Court of Appeals for the Second Circuit. Oral argument took place on August 29, 2018, and the U.S. Court of Appeals for the Second Circuit has not yet ruled on our appeal.

Discovery in the Medidata litigation is currently in process and no trial date has been set.

While it is not possible at this time to predict with any degree of certainty the ultimate outcome of this action, and we are unable to make a meaningful estimate of the amount or range of loss, if any, that could result from any unfavorable outcome, we believe that Medidata's claims lack merit.

Table of Contents

Other Litigation Matters

From time to time, we may be involved in other legal proceedings and subject to claims incident to the ordinary course of business. Although the results of such legal proceedings and claims cannot be predicted with certainty, we believe we are not currently a party to any other legal proceedings, the outcome of which, if determined adversely to us, would individually or taken together have a material adverse effect on our business, operating results, cash flows or financial position. Regardless of the outcome, such proceedings can have an adverse impact on us because of defense and settlement costs, diversion of resources and other factors, and there can be no assurances that favorable outcomes will be obtained.

Liabilities for loss contingencies arising from claims, assessments, litigation, fines and penalties and other sources are recorded when it is probable that a liability has been incurred and the amount of the assessment or remediation can be reasonably estimated. Legal costs incurred in connection with loss contingencies are expensed as incurred.

Value-Added Reseller Agreement

We have a value-added reseller agreement with salesforce.com, inc. for our use of the Salesforce1 Platform in combination with our developed technology to deliver certain of our multichannel CRM applications, including hosting infrastructure and data center operations provided by salesforce.com. The agreement, as amended, requires that we meet minimum order commitments of $500 million over the term of the agreement, which ends on September 1, 2025, including “true-up” payments if the orders we place with salesforce.com have not equaled or exceeded the following aggregate amounts within the timeframes indicated: (i) $250 million for the period from March 1, 2014 to September 1, 2020 and (ii) the full amount of $500 million by September 1, 2025. As of July 31, 2018, we remained obligated to pay fees of at least $251.6 million prior to September 1, 2025 in connection with this agreement.

Note 13. Revenues by Product

Our industry cloud solutions are grouped into two key product areas—Veeva Commercial Cloud and Veeva Vault. Veeva Commercial Cloud is a suite of multichannel CRM applications, territory allocation and alignment applications, master data management applications, and customer reference and key opinion leader data and services. Veeva Vault is a unified suite of cloud-based, enterprise content and data management applications.

Total revenues consist of the following (in thousands):

	Three Months Ended		Six Months Ended	
	July 31,		July 31,	
	2018	2017 *As adjusted	2018	2017 *As adjusted

Subscription services				
Veeva Commercial Cloud	$97,927	$87,420	$191,038	$172,378
Veeva Vault[1]	71,665	48,130	134,557	92,303
Total subscription services	$169,592	$135,550	$325,595	$264,681
Professional services				
Veeva Commercial Cloud	$14,770	$15,471	$30,931	$31,439
Veeva Vault[1]	25,247	16,774	48,630	31,447
Total professional services	$40,017	$32,245	$79,561	$62,886
Total revenues	$209,609	$167,795	$405,156	$327,567

[1] Veeva Vault revenues includes revenue from legacy Zinc Ahead products.
* See note 1 of the notes to the condensed consolidated financial statements for a summary of adjustments.

Table of Contents

Note 14. Information about Geographic Areas

We track and allocate revenues by the principal geographic area of our customers’ end users rather than by individual country, which makes it impractical to disclose revenues for the United States or other specific foreign countries. Total revenues by geographic area, which is primarily measured by the estimated location of the end users for subscription services revenues and the estimated location of the resources performing the services for professional services, were as follows for the periods shown below (in thousands):

	Three Months Ended July 31, 2018	2017 *As adjusted	Six Months Ended July 31, 2018	2017 *As adjusted
Revenues by geography				
North America	$117,158	$91,008	$226,435	$177,909
Europe and other	62,087	50,996	119,069	99,394
Asia Pacific	30,364	25,791	59,652	50,264
Total revenues	$209,609	$167,795	$405,156	$327,567

*See note 1 of the notes to the condensed consolidated financial statements for a summary of adjustments.
Long-lived assets by geographic area are as follows as of the periods shown below (in thousands):

	July 31, 2018	January 31, 2018
Long-lived assets by geography		
North America	$47,996	$49,214
Europe and other	1,645	1,840
Asia Pacific	1,064	1,230
Total long-lived assets	$50,705	$52,284

Table of Contents

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 in conjunction with our condensed consolidated financial statements and notes thereto appearing elsewhere in this report. In addition to historical condensed consolidated financial information, the following discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. Our actual results could differ materially from those anticipated by these forward-looking statements as a result of many factors. We discuss factors that we believe could cause or contribute to these differences below and elsewhere in this report, including those set forth under "Risk Factors" and "Special Note Regarding Forward-Looking Statements."

Overview

Veeva is a leading provider of industry cloud solutions for the global life sciences industry. We were founded in 2007 on the premise that industry-specific cloud solutions could best address the operating challenges and regulatory requirements of life sciences companies. Our products are designed to meet the unique needs of our customers and their most strategic business functions—from research and development (R&D) to commercialization. Our products address a broad range of needs—including multichannel CRM, content management, master data management, and data regarding healthcare professionals and organizations—and are designed to help life sciences companies bring products to market faster and more efficiently, market and sell more effectively, and maintain compliance with government regulations.

Veeva Commercial Cloud, and in particular Veeva CRM, has made up the vast majority of our revenue historically. In our fiscal year ended January 31, 2018, we derived approximately 64% of our subscription services revenues and 61% of our total revenues from our Veeva Commercial Cloud solutions. The contribution of subscription services revenues and total revenues associated with our Veeva Vault solutions are expected to increase as a percentage of subscription services revenues and total revenues going forward. However, as compared to Veeva CRM, we have less experience selling certain applications within Veeva Vault and Veeva Commercial Cloud. We are also extending certain of our solutions outside the life sciences industry in North America and Europe. Although certain of our Veeva Vault applications have begun to achieve meaningful market acceptance within the life sciences industry, to the extent that our more recently introduced solutions do not continue to achieve significant market acceptance, our business and results of operations may be adversely affected.

For our fiscal years ended January 31, 2018, 2017, and 2016, our total revenues were $690.6 million, $550.5 million and $409.2 million, respectively, representing year-over-year growth in total revenues of 25% in fiscal year ended January 31, 2018 and 35% in fiscal year ended January 31, 2017. For our fiscal years ended January 31, 2018, 2017 and 2016, our subscription services revenues were $559.4 million, $440.8 million and $316.3 million, respectively, representing year-over-year growth in subscription services revenues of 27% in fiscal year ended January 31, 2018 and 39% in fiscal year ended January 31, 2017. We expect the growth rate of our total revenues and subscription services revenues to decline in the future. We generated net income of $151.2 million, $77.6 million and $54.5 million for our fiscal years ended January 31, 2018, 2017 and 2016, respectively. As of January 31, 2018, 2017, and 2016, we served 625, 517 and 400 customers, respectively. As of January 31, 2018 and 2017, we had 311 and 270 Veeva Commercial Cloud customers, respectively, and 449 and 334 Veeva Vault customers, respectively. The combined customer counts for Veeva Commercial Cloud and Veeva Vault exceed the total customer count in each year because some customers subscribe to products in both areas. Veeva Commercial Cloud customers are those customers that have at least one of our Commercial Cloud products. Veeva Vault customers are those customers that have at least one Vault product. Many of our Veeva Vault applications are used by smaller, earlier stage pre-commercial companies, some of which may not reach the commercialization stage. Thus, the potential number of Veeva Vault customers is significantly higher than the potential number of Veeva Commercial Cloud customers.

For the six months ended July 31, 2018 and 2017, our total revenues were $405.2 million and $327.6 million, respectively, representing period-over-period growth in total revenues of 24%. For the six months ended July 31, 2018 and 2017, our subscription services revenues were $325.6 million and $264.7 million, respectively, representing period-over-period growth in subscription services revenues of 23%. In the six months ended July 31, 2018, we derived approximately 59% of our subscription services revenues and 55% of our total revenues from our Veeva Commercial Cloud solutions. We generated net income of $94.6 million and $75.6 million for the six months ended July 31, 2018 and 2017, respectively.

New Revenue Recognition Standard Under Topic 606

All results, including results from prior periods presented in this filing, related to revenues, cost of revenues, and operating expenses, and our disclosure of expectations for future periods reflect our adoption of Topic 606. Refer to note 1 of the notes to our condensed consolidated financial statements included elsewhere in this report for details regarding our adoption of Topic 606.

Key Factors Affecting Our Performance

Investment in Growth. We have invested and intend to continue to invest aggressively in expanding the breadth and depth of our product portfolio. We expect to continue to invest in research and development, to expand existing solutions and build new solutions; in sales and marketing, to promote our solutions to new and existing customers and in existing and expanded geographies and industries; in professional services to ensure the success of our customers' implementations of our solutions; and in other operational and administrative functions to support our expected growth. We anticipate that our headcount will increase as a result of these investments. We also expect our total operating expenses will continue to increase over time, which could have a negative impact on our operating margin.

Adoption of Our Solutions by Existing and New Customers. Most of our customers initially deploy our solutions to a limited number of end users within a division or geography and may only initially deploy a limited set of our available solutions. Our future growth is dependent upon our existing customers' continued success and their renewals of subscriptions to our solutions, expanded deployment of our solutions within their organizations, and their purchase of subscriptions to additional solutions. Our growth is also dependent on the adoption of our solutions by new customers.

Subscription Services Revenue Retention Rate. A key factor to our success is the renewal and expansion of our existing subscription agreements with our customers. We calculate our annual subscription services revenue retention rate for a particular fiscal year by dividing (i) annualized subscription revenue as of the last day of that fiscal year from those customers that were also customers as of the last day of the prior fiscal year by (ii) the annualized subscription revenue from all customers as of the last day of the prior fiscal year. Annualized subscription revenue is calculated by multiplying the daily subscription revenue recognized on the last day of the fiscal year by 365. This calculation includes the impact on our revenues from customer non-renewals, expanded deployment of our solutions within their organizations, deployments of additional solutions or discontinued use of solutions by our customers, and price changes for our solutions. Historically, the impact of price changes on our subscription services revenue retention rate has been minimal. For our fiscal years ended January 31, 2018, 2017, and 2016, our subscription services revenue retention rate was 121%, 127%, and 125%, respectively.

Components of Results of Operations

Revenues

We derive our revenues primarily from subscription services fees and professional services fees. Subscription services revenues consist of fees from customers accessing our cloud-based software solutions and subscription or license fees for our data solutions. Professional services and other revenues consist primarily of fees from implementation services, configuration, data services, training and managed services related to our solutions. For the six months ended July 31, 2018, subscription services revenues constituted 80% of total revenues and professional services and other revenues constituted 20% of total revenues.

We enter into master subscription agreements with our customers and count each distinct master subscription agreement that has not been terminated or expired and that has orders for which we have recognized revenue in the quarter as a distinct customer for purposes of determining our total number of current customers as of the end of that quarter. We generally enter into a single master subscription agreement with each customer, although in some instances, affiliated legal entities within the same corporate family may enter into separate master subscription agreements. Divisions, subsidiaries and operating units of our customers often place distinct orders for our subscription services under the same master subscription agreement, and we do not count such distinct orders as new customers for purposes of determining our total customer count. With respect to data services customers that have not purchased one of our software solutions, we count as a distinct customer each party that has a master subscription agreement and a known and recurring payment obligation. For purposes of determining our total customer count, we count each entity that uses a legacy Zinc Ahead product as a distinct customer if such entity is not otherwise a customer of ours.

Table of Contents

New subscription orders typically have a one-year term. If a customer adds end users or solutions to an existing order, such additional orders will generally be coterminus with the anniversary date of the initial order, and as a result, orders for additional end users or solutions will commonly have an initial term of less than one year. Subscription orders are generally billed at the beginning of the subscription commencement date in annual or quarterly increments. Because the term of orders for additional end users or solutions is commonly less than one year and payment terms may also be quarterly, the annualized value of such orders may not be completely reflected in deferred revenue at any single point in time. We have also agreed from time to time, and may agree in the future, to allow customers to change the renewal dates of their orders to, for example, align more closely with a customer’s annual budget process or to align with the renewal dates of other orders placed by other entities within the same corporate control group, or to change payment terms from annual to quarterly, or vice versa. Such changes typically result in an order of less than one year as necessary to align all orders to the desired renewal date and, thus, may result in a lesser increase to deferred revenue than if the adjustment had not occurred. Additionally, if a coterminus order of less than one year renews in the same fiscal year in which it was originally signed and has annual billing terms, the order will generate more deferred revenue in that fiscal year than the annual contract value of that order. Accordingly, we do not believe that changes on a quarterly basis in deferred revenue, unbilled accounts receivable, or calculated billings, a metric commonly cited by financial analysts, are accurate indicators of future revenues for any given period of time. Please note that since the adoption of Topic 606, we define the term calculated billings for any period to mean revenue for the period plus the change in deferred revenue from the immediately preceding period minus the change in unbilled accounts receivable from the immediately preceding period.

With respect to solutions other than Veeva CRM and particularly with respect to our Veeva Vault applications, we have entered into a number of orders with terms of up to five years. The fees associated with such orders are typically not based on the number of end-users and typically escalate over the term of such orders at a pre-agreed rate to account for, among other factors, implementation and adoption timing and planned increased usage by the customer. Similar to our orders with a one-year term, our multi-year orders are also billed in annual or quarterly increments, which means the annualized value of such orders may not be completely reflected in deferred revenue at any single point in time. Also, pursuant to Topic 606, timing differences between billings and revenue recognition with respect to our multi-year orders with escalating fees will result in fluctuations in deferred revenue and unbilled accounts receivable balances that did not occur prior to our adoption of Topic 606. For instance, when the amounts we are entitled to invoice in any period pursuant to multi-year orders is less than the revenue we are required to recognize pursuant to Topic 606, we will accrue an unbilled accounts receivable balance related to such orders. In the same scenario, the deferred revenue we would recognize in connection with such orders will be less than it would have been prior to the adoption of Topic 606 because we will be recognizing more revenue earlier in the term of such multi-year orders.

Subscription services revenues are recognized ratably over the respective non-cancelable subscription term because of the continuous transfer of control to the customer. Our subscription services agreements are generally non-cancelable during the term, although customers typically have the right to terminate their agreements for cause in the event of material breach. Subscription services revenues are affected primarily by the number of customers, the scope of the subscription purchased by each customer (for example, the number of end users or other subscription usage metric) and the number of solutions subscribed to by each customer.

We utilize our own professional services personnel and, in certain cases, third-party subcontractors to perform our professional services engagements with customers. Our professional services engagements are primarily billed on a time and materials basis and revenues are typically recognized as the services are rendered. Certain professional services revenues are based on fixed fee arrangements and revenues are recognized as services are rendered. Professional services revenues are affected primarily by our customers’ demands for implementation services, configuration, data services, training and managed services in connection with our solutions.

Cost of Revenues

Cost of subscription services revenues for all of our solutions consists of expenses related to our computing infrastructure provided by third parties, including salesforce.com and Amazon Web Services, personnel related costs associated with hosting our subscription services and providing support, including our data stewards, operating lease expense associated with computer equipment and software and allocated overhead, amortization expense associated with capitalized internal-use software related to our subscription services and amortization expense associated with purchased intangibles related to our subscription services. Cost of subscription services revenues for Veeva CRM and certain of our multichannel customer relationship management applications includes fees paid to salesforce.com for our use of the Salesforce1 Platform and the associated hosting infrastructure and data center operations that are provided by salesforce.com. We intend to continue to invest additional resources in our subscription services to enhance our product offerings and increase our delivery capacity. We may add or expand computing infrastructure capacity in the future, migrate to new computing infrastructure service providers, and make additional investments in the availability and security of our solutions.

Cost of professional services and other revenues consists primarily of employee-related expenses associated with providing these services, including salaries, benefits and stock-based compensation expense, the cost of third-party subcontractors, travel costs and allocated overhead. The cost of providing professional services is significantly higher as a percentage of the related revenues than for our subscription services due to the direct labor costs and costs of third-party subcontractors.

Operating Expenses

We accumulate certain costs such as building depreciation, office rent, utilities and other facilities costs and allocate them across the various departments based on headcount. We refer to these costs as “allocated overhead.”

Research and Development. Research and development expenses consist primarily of employee-related expenses, third-party consulting fees, hosted infrastructure costs, and allocated overhead, offset by any internal-use software development costs capitalized during the same period. We continue to focus our research and development efforts on adding new features and applications, increasing the functionality and enhancing the ease of use of our cloud-based applications.

Sales and Marketing. Sales and marketing expenses consist primarily of employee-related expenses, amortization expense associated with capitalized sales commissions, sales commissions that do not qualify for capitalization, marketing program costs, amortization expense associated with purchased intangibles related to our customer contracts, customer relationships and brand, travel-related expenses and allocated overhead. Sales commissions are costs of obtaining customer contracts and are capitalized and then amortized over a period of benefit that we have determined to be three years. Certain program spend costs are expensed as incurred.

General and Administrative. General and administrative expenses consist of employee-related expenses for our executive, finance and accounting, legal, employee success, management information systems personnel, and other administrative employees. In addition, general and administrative expenses include fees related to third-party legal counsel, fees related to third-party accounting, tax and audit services, other corporate expenses and allocated overhead.

Other Income, Net

Other income, net consists primarily of transaction gains or losses on foreign currency, net of hedging costs, interest income and amortization of premiums paid on investments.

Provision for Income Taxes

Provision for income taxes consists of federal and state income taxes in the United States and income taxes in certain foreign jurisdictions. See note 8 of the notes to our condensed consolidated financial statements.

New Accounting Pronouncements Adopted in Fiscal 2019

Refer to note 1 of the condensed consolidated financial statements for a full description of the recent accounting pronouncements adopted during the fiscal year ending January 31, 2019.

Table of Contents

Recent Accounting Pronouncements

Intangibles and Goodwill

In January 2017, the FASB issued ASU No. 2017-04, “Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment,” 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 interim goodwill impairment tests in fiscal years beginning after December 15, 2019, and early adoption is permitted for impairment tests performed on testing dates after January 1, 2017. ASU 2017-04 is to be applied on a prospective basis. We are currently evaluating the timing of adoption and do not expect the adoption of ASU 2017-04 to have a material impact on our consolidated financial statements.

Leases

In February 2016, the FASB issued ASU 2016-02, “Leases,” which requires that lease arrangements longer than 12 months result in an entity recognizing an asset and liability. The updated guidance is effective for interim and annual periods beginning after December 15, 2018, and early adoption is permitted. While we are currently evaluating the impact of the adoption of this standard on our consolidated financial statements, we expect the adoption will result in the recognition of right-of-use assets and lease liabilities that were not previously recognized, which will increase total assets and liabilities on our balance sheet. We do not expect to early adopt this accounting policy.

Tax Cuts and Jobs Act of 2017

On December 22, 2017, the Tax Act was enacted into law and amended certain provisions of the Internal Revenue Code of 1986 (IRC). Amendments to the IRC, include, among others, a reduction of the corporate income tax rate from 35% to 21% effective January 1, 2018, a transition tax on accumulated foreign earnings (transition tax), the shift from a worldwide to a territorial tax regime, and a limitation on the deductibility of executive compensation under IRC Section 162(m). Accounting Standards Codification (ASC) 740, “Income Taxes” (Topic 740), requires us to recognize the effect of the Tax Act in the period of enactment, such as remeasuring our U.S. deferred tax assets and liabilities as well as reassessing the net realizability of our deferred tax assets and liabilities.

However, the SEC staff issued Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act (SAB 118), which allows companies the ability to record provisional amounts during a measurement period not to extend more than one year beyond the Tax Act enactment date. Since the Tax Act was passed late in 2017 and further guidance and accounting interpretations are expected during the remeasurement period, our provisional estimate on the effect of the Tax Act in our financial statements remains subject to change. We have considered the impact of the Tax Act, and we expect to complete our analysis within the measurement period in accordance with SAB 118.

Table of Contents

Results of Operations

The following tables set forth selected condensed consolidated statements of operations data and such data as a percentage of total revenues for each of the periods indicated:

	Three months ended		Six months ended	
	July 31, 2018	2017 *As adjusted	July 31, 2018	2017 *As adjusted
	(in thousands)			
Consolidated Statements of Comprehensive Income Data:				
Revenues:				
Subscription services	$169,592	$135,550	$325,595	$264,681
Professional services and other	40,017	32,245	79,561	62,886
Total revenues	209,609	167,795	405,156	327,567
Cost of revenues[(1)]:				
Cost of subscription services	29,146	26,800	59,059	52,938
Cost of professional services and other	30,080	23,600	60,322	46,339
Total cost of revenues	59,226	50,400	119,381	99,277
Gross profit	150,383	117,395	285,775	228,290
Operating expenses[(1)]:				
Research and development	38,826	32,678	76,023	60,989
Sales and marketing	38,222	32,070	72,607	62,211
General and administrative	20,517	14,580	40,371	28,160
Total operating expenses	97,565	79,328	189,001	151,360
Operating income	52,818	38,067	96,774	76,930
Other income, net	3,342	2,858	5,481	3,449
Income before income taxes	56,160	40,925	102,255	80,379
Provision for income taxes	5,874	2,323	7,659	4,781
Net income	$50,286	$38,602	$94,596	$75,598

*See note 1 of the notes to the condensed consolidated financial statements for a summary of adjustments.

(1) Includes stock-based compensation as follows:

Cost of revenues:				
Cost of subscription services	$416	$376	$761	$718
Cost of professional services and other	2,657	2,133	4,985	3,822

Research and development	5,795	4,349	10,462	8,151
Sales and marketing	4,830	4,173	8,918	8,020
General and administrative	6,020	2,349	11,603	4,457
Total stock-based compensation	$19,718	$13,380	$36,729	$25,168

Table of Contents

	Three months ended				Six months ended			
	July 31, 2018		2017 *As adjusted		July 31, 2018		2017 *As adjusted	
Consolidated Statements of Comprehensive Income Data:								
Revenues:								
Subscription services	80.9	%	80.8	%	80.4	%	80.8	%
Professional services and other	19.1		19.2		19.6		19.2	
Total revenues	100.0		100.0		100.0		100.0	
Cost of revenues:								
Cost of subscription services	13.9		16.0		14.6		16.2	
Cost of professional services and other	14.4		14.1		14.9		14.1	
Total cost of revenues	28.3		30.1		29.5		30.3	
Gross profit	71.7		69.9		70.5		69.7	
Operating expenses:								
Research and development	18.5		19.5		18.8		18.6	
Sales and marketing	18.2		19.1		17.9		19.0	
General and administrative	9.8		8.6		10.0		8.6	
Total operating expenses	46.5		47.2		46.7		46.2	
Operating income	25.2		22.7		23.8		23.5	
Other income, net	1.6		1.7		1.4		1.1	
Income before income taxes	26.8		24.4		25.2		24.6	
Provision for income taxes	2.8		1.4		1.9		1.5	
Net income	24.0	%	23.0	%	23.3	%	23.1	%

* See note 1 of the notes to the condensed consolidated financial statements for a summary of adjustments.

Revenues

	Three months ended			Six months ended			
	July 31, 2018	2017 *As adjusted	% Change	July 31, 2018	2017 *As adjusted	% Change	
	(dollars in thousands)						
Revenues:							
Subscription services	$169,592	$ 135,550	25%	$325,595	$ 264,681	23	%
Professional services and other	40,017	32,245	24	79,561	62,886	27	
Total revenues	$209,609	$ 167,795	25	$405,156	$ 327,567	24	

Percentage of revenues:								
Subscription services	81	%	81	%	80	%	81	%
Professional services and other	19		19		20		19	
Total revenues	100	%	100	%	100	%	100	%

* See note 1 of the notes to the condensed consolidated financial statements for a summary of adjustments.

Total revenues for the three months ended July 31, 2018 increased $41.8 million from the same period in the prior year, of which $34.0 million was from growth in subscription services revenues. The increase in subscription services revenues consisted of $23.5 million of subscription services revenue attributable to Veeva Vault solutions and $10.5 million of subscription services revenue attributable to Veeva Commercial Cloud solutions. The geographic mix of subscription services revenues, which is primarily measured by the estimated location of end users or usage of our subscription services, was 54% from North America, 30% from Europe and other, and 16% from Asia for the three months ended July 31, 2018 and 2017. Subscription services revenues were 81% of total revenues for the three months ended July 31, 2018 and 2017.

Table of Contents

Professional services and other revenues for the three months ended July 31, 2018 increased $7.8 million from the same period in the prior year. The increase in professional services revenues was due primarily to new customers requesting implementation and deployment related professional services and existing customers requesting professional services related to expanding deployments or the deployment of newly purchased solutions. The increased demand for professional services and the resulting increase in professional services revenues was weighted heavily towards implementation and deployments of our Veeva Vault solutions. The geographic mix of professional services and other revenues, as measured by the estimated location of the resources performing the services, was 62% from North America, 28% from Europe and other, and 10% from Asia for the three months ended July 31, 2018 as compared to 59% from North America, 30% from Europe and other, and 11% from Asia for the three months ended July 31, 2017.

Total revenues for the six months ended July 31, 2018 increased $77.6 million from the same period in the prior year, of which $60.9 million was from growth in subscription services revenues. The increase in subscription services revenues consisted of $42.3 million of subscription services revenue attributable to Veeva Vault solutions and $18.7 million of subscription services revenue attributable to Veeva Commercial Cloud solutions. The geographic mix of subscription services revenues, which is primarily measured by the estimated location of end users or usage of our subscription services, was 54% from North America, 30% from Europe and other, and 16% from Asia for the six months ended July 31, 2018 as compared to 53% from North America, 30% from Europe and other, and 17% from Asia for the six months ended July 31, 2017. Subscription services revenues were 80% of total revenues for the six months ended July 31, 2018, compared to 81% of total revenues for the six months ended July 31, 2017.

Professional services and other revenues for the six months ended July 31, 2018 increased $16.7 million from the same period in the prior year. The increase in professional services revenues was due primarily to new customers requesting implementation and deployment related professional services and existing customers requesting professional services related to expanding deployments or the deployment of newly purchased solutions. The increased demand for professional services and the resulting increase in professional services revenues was weighted heavily towards implementation and deployments of our Veeva Vault solutions. The geographic mix of professional services and other revenues, as measured by the estimated location of the resources performing the services, was 62% from North America, 28% from Europe and other, and 10% from Asia for the six months ended July 31, 2018 as compared to 61% from North America, 29% from Europe and other, and 10% from Asia for the six months ended July 31, 2017. Over time, we expect the proportion of our total revenues from subscription services to increase.

Cost of Revenues and Gross Profit

	Three months ended			Six months ended		
	July 31, 2018	2017 *As adjusted	% Change	July 31, 2018	2017 *As adjusted	% Change
	(dollars in thousands)					
Cost of revenues:						
Cost of subscription services	$29,146	$ 26,800	9%	$59,059	$ 52,938	12 %
Cost of professional services and other	30,080	23,600	27	60,322	46,339	30
Total cost of revenues	$59,226	$ 50,400	18	$119,381	$ 99,277	20

Gross margin percentage:						
Subscription services	83 %	80 %		82 %	80 %	
Professional services and other	25	27		24	26	
Total gross margin percentage	72 %	70 %		71 %	70 %	
Gross profit	$150,383	$ 117,395	28%	$285,775	$ 228,290	25 %

*See note 1 of the notes to the condensed consolidated financial statements for a summary of adjustments.

Cost of revenues for the three months ended July 31, 2018 increased $8.8 million from the same period in the prior year, of which $2.3 million was related to cost of subscription services. The increase in cost of subscription services was primarily due to an increase in usage of our subscription services, which drove an increase of $1.0 million in computing infrastructure costs from Amazon Web Services, a $1.0 million increase in fees paid to salesforce.com, and an increase of $0.3 million in employee compensation-related costs. We expect cost of subscription services revenues to increase in absolute dollars in the near term as we renew existing orders and enter into new orders for our subscription services.

Table of Contents

Cost of professional services and other revenues for the three months ended July 31, 2018 increased $6.5 million from the same period in the prior year, primarily due to a $5.5 million increase in employee compensation-related costs (includes an increase of $0.5 million in stock-based compensation). The increase in employee compensation-related costs is primarily driven by the increase in headcount during the period. We expect cost of professional services and other revenues to increase in absolute dollars and as a percentage of revenue in the near term as we add personnel to our global professional services organization.

Gross margin as a percentage of total revenues for the three months ended July 31, 2018 and 2017 was 72% and 70%, respectively. Gross margin increased in the current period as compared to the same quarter in the prior period due to the growth in subscription services revenues related to our Veeva Vault solutions, which have higher gross margins as compared to our Veeva Commercial Cloud solutions.

Cost of revenues for the six months ended July 31, 2018 increased $20.1 million from the same period in the prior year, of which $6.1 million was related to cost of subscription services. The increase in cost of subscription services was primarily due to an increase in usage of our subscription services, which drove an increase of $2.8 million in computing infrastructure costs from Amazon Web Services, a $2.2 million increase in fees paid to salesforce.com, and an increase of $0.8 million in employee compensation-related costs.

Cost of professional services and other revenues for the six months ended July 31, 2018 increased $14.0 million from the same period in the prior year, primarily due to a $11.8 million increase in employee compensation-related costs (includes an increase of $1.2 million in stock-based compensation). The increase in employee compensation-related costs is primarily driven by the increase in headcount during the period.

Gross margin as a percentage of total revenues for the six months ended July 31, 2018 and 2017 was 71% and 70%, respectively. Gross margin increased in the current period as compared to the same quarter in the prior period due to the growth in subscription services revenues related to our Veeva Vault solutions, which have higher gross margins as compared to our Veeva Commercial Cloud solutions.

We expect gross margin to slightly increase in the fiscal year ending January 31, 2019 due to the subscription services revenue growth of our Veeva Vault products, which have a higher gross margin profile relative to our core CRM product, the reduction of duplicate infrastructure costs throughout the year, and our expectation that professional services revenues will decrease as a proportion of total revenues in future periods.

Operating Expenses and Operating Margin

Operating expenses include research and development, sales and marketing, and general and administrative expenses. As we continue to invest in our growth through hiring, we expect operating expenses to increase in absolute dollars and slightly as a percentage of revenue in the near term.

Research and Development

	Three months ended			Six months ended		
	July 31,			July 31,		
	2018	2017	% Change	2018	2017	% Change

		*As adjusted			*As adjusted	
	(dollars in thousands)					
Research and development	$38,826	$ 32,678	19%	$76,023	$ 60,989	25%
Percentage of total revenues	19 %	20 %		19 %	19 %	

* See note 1 of the notes to the condensed consolidated financial statements for a summary of adjustments.

Research and development expenses for the three months ended July 31, 2018 increased $6.1 million from the same period in the prior year, primarily due to an increase of $6.0 million in employee compensation-related costs (includes an increase of $1.4 million in stock-based compensation) resulting from increased headcount during the period. The expansion of our headcount in this area is to support the increased number of products that we offer.

Table of Contents

Research and development expenses for the six months ended July 31, 2018 increased $15.0 million from the same period in the prior year, primarily due to an increase of $12.7 million in employee compensation-related costs (includes an increase of $2.3 million in stock-based compensation) resulting from increased headcount during the period. The expansion of our headcount in this area is to support the increased number of products that we offer.

We expect research and development expenses to increase in absolute dollars and may increase as a percentage of revenue in the near term, primarily due to higher headcount as we continue to add research and development personnel, invest in our solutions, and develop new technologies.

Sales and Marketing

	Three months ended			Six months ended		
	July 31,			July 31,		
	2018	2017 *As adjusted	% Change	2018	2017 *As adjusted	% Change
	(dollars in thousands)					
Sales and marketing	$38,222	$ 32,070	19%	$72,607	$ 62,211	17%
Percentage of total revenues	18 %	19 %		18 %	19 %	

*See note 1 of the notes to the condensed consolidated financial statements for a summary of adjustments.

Sales and marketing expenses for the three months ended July 31, 2018 increased $6.2 million from the same period in the prior year, primarily due to an increase of $4.6 million in employee compensation-related costs (includes an increase of $0.7 million in stock-based compensation) and an increase of $0.7 million in marketing program costs. The overall increase in employee compensation-related costs was primarily driven by increase in headcount during the period.

Sales and marketing expenses for the six months ended July 31, 2018 increased $10.4 million from the same period in the prior year, primarily due to an increase of $9.2 million in employee compensation-related costs (includes an increase of $0.9 million in stock-based compensation) and an increase of $1.3 million in marketing program costs. The overall increase in employee compensation-related costs was primarily driven by increase in headcount during the period.

We expect sales and marketing expenses to continue to grow in absolute dollars in the near term, primarily due to employee-related expenses as we increase our headcount to support our sales and marketing efforts associated with our newer solutions and our continued expansion of our sales capacity across all our solutions.

Note that since the adoption of Topic 606, we now capitalize and amortize commissions, whereas we previously expensed them in the period in which they were incurred. Normally, this change would have reduced our sales and marketing expenses as compared to the prior accounting treatment. However, beginning in our fiscal year ending January 31, 2019 and unrelated to Topic 606, our sales compensation model shifted to a higher mix of fixed compensation, which is expensed in the period incurred. Due to these simultaneous changes, we do not expect the adoption of Topic 606 to cause a material change in our sales and marketing expenses for our fiscal year ending January 31, 2019.

General and Administrative

	Three months ended			Six months ended		
	July 31, 2018	2017 *As adjusted	% Change	July 31, 2018	2017 *As adjusted	% Change
	(dollars in thousands)					
General and administrative	$20,517	$ 14,580	41%	$40,371	$ 28,160	43%
Percentage of total revenues	10 %	9 %		10 %	9 %	

* See note 1 of the notes to the condensed consolidated financial statements for a summary of adjustments.

Table of Contents

General and administrative expenses for the three months ended July 31, 2018 increased $5.9 million from the same period in the prior year, primarily due to an increase of $4.2 million in employee compensation-related costs (includes an increase of $3.7 million in stock-based compensation, which primarily reflects the full quarter impact of a stock option grant to our chief executive officer during our fiscal year ended January 31, 2018) and an increase of $1.0 million in legal fees related to litigation activity during the period.

General and administrative expenses for the six months ended July 31, 2018 increased $12.2 million from the same period in the prior year, primarily due to an increase of $9.0 million in employee compensation-related costs (includes an increase of $7.1 million in stock-based compensation, which primarily reflects the full year-to-date impact of a stock option grant to our chief executive officer during our fiscal year ended January 31, 2018) and an increase of $1.0 million in legal fees related to litigation activity during the period.

We expect general and administrative expenses to continue to grow in absolute dollars in the near term as we continue to invest in our business and infrastructure. Such costs include increases in headcount in our finance, legal, and employee success functions, third-party legal fees, particularly in relation to the matters described in Part II, Item 1. “Legal Proceedings,” and additional accounting, tax and compliance-related fees. We also expect an increase on a year-over-year basis in general and administrative expenses related to the stock-based compensation associated with a stock option grant to our chief executive officer during our fiscal year ended January 31, 2018.

Other Income, Net

	Three months ended			Six months ended		
	July 31, 2018	2017	% Change	July 31, 2018	2017	% Change
	(dollars in thousands)					
Other income, net	$3,342	$2,858	17%	$5,481	$3,449	59%

Other income, net for the three months ended July 31, 2018 increased $0.5 million from the same period in the prior year, primarily due to an increase in interest and other income of $1.7 million driven by higher cash and cash equivalent balances and higher yield in the current period, which was offset by a change in foreign currency gains and losses of $2.0 million from the prior year period, which includes gains and losses from foreign currency exposures partially offset by hedge positions. Other income, net for the six months ended July 31, 2018 increased $2.0 million from the same period in the prior year, primarily due to an increase in interest and other income of $2.9 million driven by higher cash and cash equivalent balances and higher yield in the current period. In addition, there was a decrease of $1.4 million in amortization of investments, which was offset by a change in foreign currency gains and losses of $2.3 million from the prior year period, which includes gains and losses from foreign currency exposures partially offset by hedge positions. We continue to experience foreign currency fluctuations primarily due to the impact resulting from the periodic re-measurement of our foreign currency balances that are denominated in currencies other than the functional currency of the entities in which they are recorded. Our results of operations are subject to fluctuations due to changes in foreign currency exchange rates, particularly changes in the Euro, British Pound Sterling, Japanese Yen and Chinese Yuan. We may continue to experience favorable or adverse foreign currency impacts due to volatility in these currencies.

Provision for Income Taxes

	Three months ended			Six months ended		
	July 31, 2018	2017 *As adjusted	% Change	July 31, 2018	2017 *As adjusted	% Change
	(dollars in thousands)					
Income before income taxes	$56,160	$ 40,925	37%	$102,255	$ 80,379	27%
Provision for income taxes	5,874	2,323	153%	7,659	4,781	60%
Effective tax rate	10.5 %	5.7 %		7.5 %	5.9 %	

*See note 1 of the notes to the condensed consolidated financial statements for a summary of adjustments.

Our effective tax rate is the result of the mix of income earned in various tax jurisdictions that are subject to a broad range of income tax rates. The provision for income taxes differs from the tax computed at the U.S. federal statutory income tax rate due primarily to income earned in jurisdictions with higher statutory tax rates, state taxes, tax credits, equity compensation, and foreign income subject to taxation in the United States. On May 1, 2018 the IRS issued a closing audit notice related to the income tax return for fiscal year ended January 31, 2015. On May 31, 2018 we settled our employment tax audit for calendar years 2015 and 2016. The settlement of both the audits resulted in an immaterial impact to our financial statements. Currently, fiscal years ended January 31, 2016 and forward remain open for an IRS income tax audit.

For the three months ended July 31, 2018 and 2017, our effective tax rates were 10.5% and 5.7%, respectively. During the three months ended July 31, 2018 as compared to the prior year period, our effective tax rate increased primarily due to a decrease in excess tax benefits, which was partially offset by a reduced federal tax rate as a result of the Tax Act. We recognized excess tax benefits in our provision for income taxes of $9.3 million and $14.8 million for the three months ended July 31, 2018 and 2017, respectively.

For the six months ended July 31, 2018 and 2017, our effective tax rates were 7.5% and 5.9%, respectively. During the six months ended July 31, 2018 as compared to the prior year period, our effective tax rate increased primarily due to a decrease in excess tax benefits, which was partially offset by a reduced federal tax rate as a result of the Tax Act. We recognized excess tax benefits in our provision for income taxes of $19.0 million and $28.7 million for the six months ended July 31, 2018 and 2017, respectively.

In addition, we may experience material changes to effective tax rate based on the enactment of the Tax Act as well as additional guidance from the Department of Treasury. See “Tax Cuts and Jobs Act of 2017” above for more information. We expect additional provisions of the Tax Act, such as the amendment to Section 162(m) to apply to us in the future. We will continue to identify and analyze other applicable provisions from the 2017 Act that may impact our fiscal year ending January 31, 2019 and in the future.

Non-GAAP Financial Measures

In our public disclosures, we have provided non-GAAP measures, which we define as financial information that has not been prepared in accordance with generally accepted accounting principles in the United States, or GAAP. In addition to our GAAP measures, we use these non-GAAP measures internally for budgeting and resource allocation purposes and in analyzing our financial results.

For the reasons set forth below, we believe that excluding the following items from our non-GAAP financial measures provides information that is helpful in understanding our operating results, evaluating our future prospects, comparing our financial results across accounting periods, and comparing our financial results to our peers, many of which provide similar non-GAAP financial measures.

- Stock-based compensation expenses. We exclude stock-based compensation expenses from our non-GAAP measures primarily because they are non-cash expenses that we exclude from our internal management reporting processes. We also find it useful to exclude these expenses when we assess the appropriate level of various operating expenses and resource allocations when budgeting, planning and forecasting future periods. Moreover, because of varying available valuation methodologies, subjective assumptions and the variety of award types that companies can use under FASB ASC Topic 718, we believe excluding stock-based compensation expenses allows investors to make meaningful comparisons between our recurring core business operating results and those of other companies.

- Amortization of purchased intangibles. We incur amortization expense for purchased intangible assets in connection with acquisitions of certain businesses and technologies. Amortization of intangible assets is a non-cash expense and is inconsistent in amount and frequency because it is significantly affected by the timing, size of acquisitions and the inherent subjective nature of purchase price allocations. Because these costs have already been incurred and cannot be recovered, and are non-cash expenses, we exclude these expenses for internal management reporting processes. We also find it useful to exclude these charges when assessing the appropriate level of various operating expenses and resource allocations when budgeting, planning and forecasting future periods. Investors should note that the use of intangible assets contributed to our revenues earned during the periods presented and will contribute to our future period revenues as well.

Table of Contents

- Capitalization of internal-use software development expenses and the subsequent amortization of the capitalized expenses. We capitalize certain costs incurred for the development of computer software for internal use and then amortize those costs over the estimated useful life. Capitalization and amortization of software development costs can vary significantly depending on the timing of products reaching technological feasibility and being made generally available. Our internal management reporting processes exclude both the capitalization of software (which would otherwise result in a reduction in net research and development operating expenses) and the amortization of capitalized software (which would otherwise result in an increase in cost of subscription revenues) when preparing budgets, plans and reviewing internal performance. Moreover, because of the variety of approaches taken and the subjective assumptions made by other companies in this area, we believe that excluding the effects of capitalized software costs allows investors to make more meaningful comparisons between our operating results and those of other companies.
- Deferred compensation associated with the Zinc Ahead acquisition. The Zinc Ahead share purchase agreement, as revised, called for share purchase consideration to be deferred and paid at a rate of one-third of the deferred consideration amount per year to certain former Zinc Ahead employee shareholders and option holders who remain employed with us on each deferred consideration payment date. In accordance with GAAP, these payments are being accounted for as deferred compensation and the expense is recognized over the requisite service period. We view this deferred compensation expense as an unusual acquisition cost associated with the Zinc Ahead acquisition and find it useful to exclude it in order to assess the appropriate level of various operating expenses to assist in budgeting, planning and forecasting future periods. We believe excluding this deferred compensation expense from our non-GAAP measures may allow investors to make more meaningful comparisons between our recurring operating results and those of other companies.
- Income tax effects on the difference between GAAP and non-GAAP costs and expenses. The income tax effects that are excluded from the non-GAAP measures relate to the imputed tax impact on the difference between GAAP and non-GAAP costs and expenses due to stock-based compensation, purchased intangibles, capitalized internal-use software and deferred compensation associated with the Zinc Ahead acquisition for GAAP and non-GAAP measures.

Limitations on the use of Non-GAAP financial measures

There are limitations to using non-GAAP financial measures because non-GAAP financial measures are not prepared in accordance with GAAP and may be different from non-GAAP financial measures provided by other companies.

The non-GAAP financial measures are limited in value because they exclude certain items that may have a material impact upon our reported financial results. In addition, they are subject to inherent limitations as they reflect the exercise of judgments by management about which items are adjusted to calculate our non-GAAP financial measures. We compensate for these limitations by analyzing current and future results on a GAAP basis as well as a non-GAAP basis and also by providing GAAP measures in our public disclosures.

Non-GAAP financial measures should not be considered in isolation from, or as a substitute for, financial information prepared in accordance with GAAP. We encourage investors and others to review our financial information in its entirety, not to rely on any single financial measure to evaluate our business, and to view our non-GAAP financial measures in conjunction with the most directly comparable GAAP financial measures.

Table of Contents

The following table reconciles the specific items excluded from GAAP metrics in the calculation of non-GAAP metrics for the periods shown below:

	Three months ended		Six months ended	
	July 31, 2018	2017 *As adjusted	July 31, 2018	2017 *As adjusted
Operating income on a GAAP basis	$52,818	$38,067	$96,774	$76,930
Stock-based compensation expense	19,718	13,380	36,729	25,168
Amortization of purchased intangibles	1,783	1,986	3,631	3,988
Capitalization of internal-use software	(284)	(243)	(514)	(1,033)
Amortization of internal-use software	154	159	310	280
Deferred compensation associated with Zinc Ahead acquisition	129	130	258	267
Operating income on a non-GAAP basis	$74,318	$53,479	$137,188	$105,600
Net income on a GAAP basis	$50,286	$38,602	$94,596	$75,598
Stock-based compensation expense	19,718	13,380	36,729	25,168
Amortization of purchased intangibles	1,783	1,986	3,631	3,988
Capitalization of internal-use software	(284)	(243)	(514)	(1,033)
Amortization of internal-use software	154	159	310	280
Deferred compensation associated with Zinc Ahead acquisition	129	130	258	267
Income tax effect on non-GAAP adjustments[1]	(10,435)	(17,395)	(22,302)	