

PROOFPOINT INC
Form 10-Q
August 08, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2012

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 001-35506
PROOFPOINT, INC.

(Exact name of Registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

51-0414846

(I.R.S. employer
identification no.)

892 Ross Drive

Sunnyvale, California

(Address of principal executive offices)

94089

(Zip Code)

(408) 517-4710

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 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, or a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting 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

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

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Shares of Proofpoint, Inc. common stock, \$0.0001 par value per share, outstanding as of August 1, 2012: 31,833,321 shares.

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PROOFPOINT, INC.

FORM 10-Q

Quarterly Period Ended June 30, 2012

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

Proofpoint, Inc.

Condensed Consolidated Balance Sheets

(In thousands, except per share amounts)

(Unaudited)

	June 30, 2012	December 31, 2011
Assets		
Current assets		
Cash and cash equivalents	\$46,157	\$9,767
Short-term investments	35,197	2,947
Accounts receivable, net	12,237	15,789
Inventory	506	729
Deferred product costs, current	1,526	1,803
Prepaid expenses and other current assets	2,867	2,556
Total current assets	98,490	33,591
Property and equipment, net	7,472	7,353
Deferred product costs, noncurrent	495	987
Goodwill	18,557	18,557
Intangible assets, net	3,738	6,189
Other noncurrent assets	249	1,275
Total assets	\$129,001	\$67,952
Liabilities, Convertible Preferred Stock and Stockholders' Equity (Deficit)		
Current liabilities		
Accounts payable	\$2,121	\$3,504
Accrued liabilities	9,623	10,061
Notes payable and lease obligations	1,650	467
Deferred rent	512	517
Deferred revenue	54,184	52,836
Total current liabilities	68,090	67,385
Notes payable and lease obligations, noncurrent	3,147	4,514
Other long term liabilities, noncurrent	252	85
Deferred revenue, noncurrent	21,722	23,404
Total liabilities	93,211	95,388
Convertible preferred stock, \$0.0001 par value; no shares authorized, issued and outstanding as of June 30, 2012 and 39,424 shares authorized, 38,942 shares issued and outstanding at December 31, 2011, net of issuance costs and liquidation preference of \$110,338	—	109,911
Stockholders' equity (deficit)		
Preferred stock, \$0.0001 par value; 5,000 shares authorized; no shares issued and outstanding at June 30, 2012; no shares authorized, issued and outstanding at December 31, 2011	—	—
Common stock, \$0.0001 par value; 200,000 and 71,400 shares authorized at June 30, 2012 and December 31, 2011, respectively; 31,795 and 4,961 shares issued		1

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and outstanding at June 30, 2012 and December 31, 2011, respectively

Additional paid-in capital	208,188	24,773	
Accumulated other comprehensive loss	(12	) (3)
Accumulated deficit	(172,390	) (162,118)
Total stockholders' equity (deficit)	35,790	(137,347)
Total liabilities, convertible preferred stock, and stockholders' equity (deficit)	\$ 129,001	\$ 67,952	

See accompanying Notes to the Condensed Consolidated Financial Statements.

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Proofpoint, Inc.
Condensed Consolidated Statements of Operations
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2012	2011	2012	2011
Revenue:				
Subscription	\$24,750	\$17,663	\$48,019	\$33,740
Hardware and services	1,193	2,217	2,543	4,921
Total revenue	25,943	19,880	50,562	38,661
Cost of revenue:(1)(2)				
Subscription	7,236	5,801	14,447	11,617
Hardware and services	1,134	1,530	2,303	3,113
Total cost of revenue	8,370	7,331	16,750	14,730
Gross profit	17,573	12,549	33,812	23,931
Operating expense:(1)(2)				
Research and development	6,224	4,881	12,105	9,822
Sales and marketing	13,450	9,846	25,625	19,291
General and administrative	2,964	2,092	5,730	4,140
Total operating expense	22,638	16,819	43,460	33,253
Operating loss	(5,065)	(4,270)	(9,648)	(9,322)
Interest expense, net	(43)	(112)	(103)	(188)
Other income (expense), net	(178)	94	(209)	243
Loss before provision for income taxes	(5,286)	(4,288)	(9,960)	(9,267)
Provision for income taxes	(232)	(30)	(311)	(136)
Net loss	\$(5,518)	\$(4,318)	\$(10,271)	\$(9,403)
Net loss per share, basic and diluted	\$(0.21)	\$(1.10)	\$(0.65)	\$(2.43)
Weighted average shares outstanding, basic and diluted	26,195	3,909	15,907	3,871
(1) Includes stock based compensation expense as follows:				
Cost of subscription revenue	\$109	\$107	\$238	\$205
Cost of hardware and services revenue	15	6	26	13
Research and development	485	283	907	561
Sales and marketing	820	478	1,471	907
General and administrative	506	239	794	484
(2) Includes intangible amortization expense as follows:				
Cost of subscription revenue	\$1,019	\$935	\$2,119	\$1,860
Research and development	7	—	15	—
Sales and marketing	146	141	317	484

See accompanying Notes to the Condensed Consolidated Financial Statements.

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Proofpoint, Inc.
 Condensed Consolidated Statements of Comprehensive Loss
 (In thousands)
 (Unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2012	2011	June 30, 2012	2011
Net loss	\$(5,518	) \$(4,318	) \$(10,271	) \$(9,403
Other comprehensive income, before tax and net of reclassification adjustments:				
Unrealized losses on investments, net	(11	) (3	) (9	) (3
Other comprehensive loss, before tax	(11	) (3	) (9	) (3
Tax benefit (provision) related to items of other comprehensive income	—	—	—	—
Other comprehensive loss, net tax	(11	) (3	) (9	) (3
Comprehensive loss	\$(5,529	) \$(4,321	) \$(10,280	) \$(9,406

See accompanying Notes to the Condensed Consolidated Financial Statements.

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Proofpoint, Inc.
Condensed Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Six Months Ended	
	June 30,	
	2012	2011
Cash flows from operating activities		
Net loss	\$(10,271	) \$(9,403
Adjustments to reconcile net loss to net cash provided by operating activities		
Depreciation and amortization	4,499	3,788
Stock based compensation	3,436	2,170
Change in fair value of warrant liability	—	(66
Change in fair value of contingent earn-outs	—	161
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable	3,552	1,014
Inventory	223	(60
Deferred products costs	768	1,706
Prepaid expenses and other current assets	(311	) (509
Noncurrent assets	59	166
Accounts payable	(1,296	) 374
Accrued liabilities	790	(964
Deferred rent	(5	) 177
Deferred revenue	(334	) 2,069
Net cash provided by operating activities	\$1,110	\$623
Cash flows from investing activities		
Proceeds from sales and maturities of short-term investments	\$2,939	\$411
Purchase of short-term investments	(35,198	) (5,081
Acquisitions of business (net of cash acquired)	—	(2,136
Purchase of property and equipment, net	(2,443	) (160
Net cash used in investing activities	\$(34,702	) \$(6,966
Cash flows from financing activities		
Proceeds from issuance of common stock, net of repurchases	\$1,761	\$418
Proceeds from initial public offering, net of offering costs	68,405	—
Proceeds of equipment financing loans	—	1,728
Repayments of equipment financing loans	(184	) (138
Net cash provided by financing activities	\$69,982	\$2,008
Net increase (decrease) in cash and cash equivalents	36,390	(4,335
Cash and cash equivalents		
Beginning of period	9,767	12,087
End of period	\$46,157	\$7,752

See accompanying Notes to the Condensed Consolidated Financial Statements.

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Proofpoint, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

(Dollars and share amounts in thousands, except per share amounts)

1. The Company and Summary of Significant Accounting Policies

The Company

Proofpoint, Inc. (the “Company”) was incorporated in Delaware in June 2002 and is headquartered in California. Proofpoint is a pioneering security-as-a-service vendor that enables large and mid-sized organizations worldwide to defend, protect, archive and govern their most sensitive data. The Company’s security-as-a-service platform is comprised of a number of data protection solutions, including threat protection, regulatory compliance, archiving and governance, and secure communication.

Reverse Stock Split

On March 30, 2012, the Company's Board of Directors approved a 1-for-2 reverse stock split of the Company's common stock. The reverse stock split became effective on April 2, 2012. Upon the effectiveness of the reverse stock split, (i) every two shares of outstanding common stock was decreased to one share of common stock, (ii) the number of shares of common stock into which each outstanding option to purchase common stock is exercisable was proportionally decreased on a 1-for-2 basis, (iii) the exercise price of each outstanding option to purchase common stock was proportionately increased on a 1-for-2 basis, and (iv) the conversion ratio for each share of preferred stock outstanding was proportionately reduced on a 1-for-2 basis. All of the share numbers, share prices, and exercise prices have been retrospectively adjusted to reflect the reverse stock split.

Basis of Presentation and Consolidation

The accompanying unaudited condensed consolidated financial statements and condensed footnotes have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for fair statement have been included. The results of operations for the three and six months ended June 30, 2012 are not necessarily indicative of the results to be expected for the year ended December 31, 2012 or for other interim periods or for future years. The accompanying unaudited condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated on consolidation. The condensed consolidated balance sheet as of December 31, 2011 is derived from audited financial statements as of that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in our Prospectus dated April 19, 2012, filed with the SEC pursuant to Rule 424(b)(4) under the Securities Act of 1933 (the “Securities Act”), as amended.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of expenses during the reporting period. Actual results could differ from those estimates and such difference may be material to the financial statements.

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Foreign Currency Remeasurement and Transactions

The Company's sales to international customers are generally U.S. dollar denominated. As a result, there are no significant foreign currency gains or losses related to these transactions. The functional currency for the Company's wholly-owned foreign subsidiaries is the U.S. dollar. Accordingly, the subsidiaries remeasure monetary assets and liabilities at period-end exchange rates, while nonmonetary items are remeasured at historical rates. Income and expense accounts are remeasured at the average exchange rates in effect during the year. Remeasurement adjustments are recognized in the consolidated statement of operations as transaction gains or losses within other income (expense), net, in the period of occurrence. Aggregate transaction gains (losses) included in determining net loss were \$(187) and \$27 for the three months, and \$(217) and \$121 for the six months ended June 30, 2012 and 2011, respectively.

Cash, Cash Equivalents and Short Term Investments

The Company considers all highly liquid instruments purchased with an original maturity date of 90 days or less from the date of purchase to be cash equivalents. Cash equivalents consist of money market funds and certain commercial paper. Cash and cash equivalents were \$46,157 and \$9,767 as of June 30, 2012 and December 31, 2011, respectively. Short-term investments consist of readily marketable securities with remaining maturity of more than three months from the date of purchase and include commercial paper, corporate bonds, debt securities and certificates of deposit. Short-term investments were \$35,197 and \$2,947 as of June 30, 2012 and December 31, 2011, respectively, and all were classified as available-for-sale and were carried at fair value, with unrealized gains and losses reported as a component of accumulated other comprehensive loss. Realized gains and losses are included in "other income (expense), net." Fair value is estimated based on available market information. The cost of securities sold is based on the specific identification method.

Revenue Recognition

The Company derives its revenue primarily from two sources: (1) subscription revenue for rights related to the use of the security-as-a-service platform and (2) hardware, training and professional services revenue provided to customers related to their use of the platform. Subscription revenue is derived from a subscription based enterprise licensing model with contract terms typically ranging from one to three years, and consist of (i) subscription fees from the licensing of the security-as-a-service platform, (ii) subscription fees for access to the on-demand elements of the platform and (iii) subscription fees for the right to access the Company's customer support services.

The Company applies the provision of ASC 985-605, "Software Revenue Recognition," and related interpretations, to all transactions involving the licensing of software, as well as related support, training, and other professional services. ASC 985-605 requires revenue earned on software arrangements involving multiple elements such as software license, support, training and other professional services to be allocated to each element based on the relative fair values of these elements. The fair value of an element must be based on vendor specific objective evidence ("VSOE") of fair value. VSOE of fair value of each element is based on the price charged when the element is sold separately. Revenue is recognized when all of the following criteria are met as set forth in ASC 985-605:

• Persuasive evidence of an arrangement exists,

• Delivery has occurred,

• The fee is fixed or determinable, and

• Collectability is probable.

The Company has analyzed all of the elements included in its multiple element arrangements and has determined that it does not have sufficient VSOE of fair value to allocate revenue to its subscription and software license agreements, support, training, and professional services. The Company defers all revenue under the software arrangement until the commencement of the subscription services and any associated professional services. Once the subscription services and the associated professional services have commenced, the entire fee from the arrangement is recognized ratably over the remaining period of the arrangement. If the professional services are essential to the functionality of the subscription, then the revenue recognition does not commence until such services are completed.

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In the consolidated statement of operations, revenue is categorized as "subscription" and "hardware and services." Although the Company is unable to separate its multiple elements under the applicable revenue recognition guidance since it does not have sufficient VSOE of fair value for revenue recognition purposes, the Company has used a systematic and rational estimate to classify revenue between "subscription" and "hardware and services." For presentation purposes only, the Company allocates revenue to hardware and services based upon management's best estimate of fair value of such deliverables using a cost plus model. The remaining consideration of the arrangement is then allocated to subscription services. Management believes that this methodology provides a reasonable basis to allocate revenue between subscription and hardware and services for presentation purposes.

The hosted on-demand service agreements do not provide customers with the right to take possession of the software supporting the hosted service. The Company recognizes revenue from its hosted on-demand services in accordance with ASC 605-20, and as such recognizes revenue when the following criteria are met:

• Persuasive evidence of an arrangement exists,

• Delivery of the Company's obligations to its customers has occurred,

• Collection of the fees is probable, and

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

In October 2009, the FASB amended the accounting guidance for multiple element arrangements ("ASU 2009-13") to:

• Provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and how the arrangement consideration should be allocated among its elements;

• Require an entity to allocate revenue in an arrangement that has separate units of accounting using best estimated selling price ("BESP") of deliverables if a vendor does not have VSOE of fair value or third-party evidence of selling price ("TPE"), and

• Eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method to the separate unit of accounting.

Concurrently, the FASB amended the accounting guidance for revenue recognition ("ASU 2009-14") to exclude hardware appliances containing software components and hardware components that function together to deliver the hardware appliance's essential functionality from the scope of the software revenue recognition guidance of ASC 985-605.

The Company elected to adopt this new guidance in the first quarter of fiscal 2011 for new and materially modified revenue arrangements originating after January 1, 2011.

Prior to the adoption of ASU 2009-14, revenue derived from hardware appliance sales were recognized based on the software revenue recognition guidance. The Company could not establish VSOE of fair value for the undelivered elements in the arrangement, and therefore the entire fee from the arrangement was recognized ratably over the contractual term of the agreement. In addition, the Company was unable to establish VSOE of fair value of its hosted on-demand service agreements, and therefore the entire fee for the agreement was recognized ratably over the contractual term of the agreement.

As a result of the adoption of this accounting guidance, revenue derived from our subscription services and hardware appliance sales are no longer subject to industry specific software revenue recognition guidance. For all arrangements within the scope of these new accounting pronouncements, including the Company's hosted on-demand services, the Company evaluates each element in a multiple element arrangement to determine whether it represents a separate unit of accounting. An element constitutes a separate unit of accounting when the delivered item has standalone value and delivery of the undelivered element is probable and within the Company's control. Revenue derived from the licensing of the security-as-a-service platform continues to be accounted for in accordance with the industry specific revenue recognition guidance.

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Hardware appliance revenue is recognized upon shipment. Subscription and support revenue are recognized over the contract period commencing on the start date of the contract. Professional services and training, when sold with hardware appliances or subscription and support services, are accounted for separately when those services have standalone value. In determining whether professional services and training services can be accounted for separately from subscription and support services, the Company considers the following factors: availability of the services from other vendors, the nature of the services, and the dependence of the subscription services on the customer's decision to buy the professional services. If professional services and training do not qualify for separate accounting, the Company recognizes the professional services and training ratably over the contract term of the subscription services. Delivery generally occurs when the hardware appliance is delivered to a common carrier freight on board shipping point by the Company or the hosted service has been activated and communicated to the customer accordingly. The Company's fees are typically considered to be fixed or determinable at the inception of an arrangement and are negotiated at the outset of an arrangement, generally based on specific products and quantities to be delivered. In the event payment terms are provided that differ significantly from its standard business practices, the fees are deemed to not be fixed or determinable and revenue is recognized as the fees become paid.

The Company assesses collectability based on a number of factors, including credit worthiness of the customer and past transaction history of the customer. Through June 30, 2012, the Company has not experienced significant credit losses.

Deferred Revenue

Deferred revenue primarily consists of billings or payments received in advance of revenue recognition from the sale of the Company's subscription fees, training and professional services. Once the revenue recognition criteria are met, this revenue is recognized ratably over the term of the associated contract, which typically ranges from 12 to 36 months.

Fair Value of Financial Instruments

The carrying amounts of certain of the Company's cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate their fair values due to their short maturities. Based on borrowing rates that are available to the Company for loans with similar terms and consideration of the Company's credit risk, the carrying value of the note payable approximates its fair value.

Comprehensive Income (Loss)

Comprehensive income (loss) includes all changes in equity that are not the result of transactions with stockholders. The Company's comprehensive income (loss) consists of its net loss and changes in unrealized gains (losses) from its available-for-sale investments. For the Company's first reporting period beginning after December 15, 2011, the Company adopted guidance issued by FASB amending the presentation of the Statement of Comprehensive Income. The amended guidance eliminates the current option to report other comprehensive income and its components of other comprehensive income as part of the statement of changes in stockholders' equity. In addition, it gives an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The Company has implemented this guidance effective going forward as of the quarter ended March 31, 2012.

2. Acquisitions

Spam and Open Relay Blocking System ("SORBS")

On June 30, 2011, the Company entered into an asset purchase agreement (the "SORBS Agreement") with GFI Software Ltd., a British Virgin Islands corporation.

Under the terms of the SORBS agreement, the Company paid consideration of \$200 for intellectual property and fixed assets with \$40 being held in escrow to secure indemnification obligations. The acquisition related costs of \$28 incurred by the Company was charged to operating expenses in the year ended December 31, 2011.

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Of the total cash consideration paid, \$120 was allocated to goodwill as the intellectual property purchased did not meet the criteria for purchase price allocations as set forth in ASC 805, Business Combinations, and \$46 was recorded as fixed assets. The following table summarizes the allocation of the purchase price and the estimated useful lives of the identifiable intangible assets acquired as of the date of the acquisition:

	Estimated Fair Value	Estimated Useful Life
Tangible assets acquired	\$46	1 year
Liabilities assumed	—	
Developed technology	34	2 years
Customer relationships	—	
Vendor relationships	—	
Goodwill	120	Indefinite
	\$200	

There were no acquisition related activities for the three or six months ended June 30, 2012.

3. Goodwill and Intangible Assets

Goodwill represents the excess of the purchase price of the acquired enterprise over the fair value of identifiable assets acquired and liabilities assumed. The Company applies ASC 350, “Intangibles—Goodwill and Other,” and performs an annual goodwill impairment test during the fourth quarter of the Company’s fiscal year and more frequently if an event or circumstance indicates that an impairment may have occurred. For the purposes of impairment testing, the Company has determined that it has one reporting unit. A two-step impairment test of goodwill is required pursuant to ASC 350-20-35. In the first step, the fair value of the reporting unit is compared to its carrying value. If the fair value exceeds the carrying value, goodwill is not impaired and further testing is not required. If the carrying value exceeds the fair value, then the second step of the impairment test is required to determine the implied fair value of the reporting unit’s goodwill. The implied fair value of goodwill is calculated by deducting the fair value of all tangible and intangible net assets of the reporting unit, excluding goodwill, from the fair value of the reporting unit as determined in the first step. If the carrying value of the reporting unit’s goodwill exceeds its implied fair value, then an impairment loss must be recorded that is equal to the difference. The identification and measurement of goodwill impairment involves the estimation of the fair value of the Company. The estimate of fair value of the Company, based on the best information available as of the date of the assessment, is subjective and requires judgment, including management assumptions about expected future revenue forecasts and discount rates. No impairment to the carrying value of goodwill was identified by the Company during the six months ended June 30, 2012.

Intangible assets consist of developed technology, customer relationships, vendor relationships, non-compete arrangements and trademarks and patents. The values assigned to intangibles are based on estimates and judgments regarding expectations for success and life cycle of solutions and technologies acquired.

Intangible assets are amortized on a straight-line basis over their estimated lives, which approximate the pattern in which the economic benefits of the intangible assets are consumed, typically ranging from 2 to 4 years.

Developed technology	4 years
Customer relationships	4 years
Vendor relationships	4 years

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The goodwill activity and balances are presented below:

	June 30, 2012	December 31, 2011
Opening balance	\$18,557	\$15,932
Add: Goodwill from acquisitions	—	2,625
Closing balance	\$18,557	\$18,557

The goodwill balance as of June 30, 2012 and December 31, 2011 was the result of the acquisitions of Fortiva, Inc., Secure Data in Motion, Inc (“Sigaba”), Everyone.net, Inc. (“EDN”), GFI Software Ltd., (Spam and Open Relay Blocking System or “SORBS”) and NextPage, Inc..

Intangible Assets

Intangible assets excluding goodwill, consisted of the following:

	June 30, 2012			December 31, 2011		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	\$17,641	\$(14,497)	\$3,144	\$17,641	\$(12,378)	\$5,263
Customer relationships	2,408	(1,975)	433	2,408	(1,685)	723
Vendor relationships	—	—	—	290	(290)	—
Non compete	106	(14)	92	106	(1)	105
Trademark and patents	98	(29)	69	98	—	98
	\$20,253	\$(16,515)	\$3,738	\$20,543	\$(14,354)	\$6,189

In the quarter ended March 31, 2011, the Company revised the useful life of the vendor relationship intangible asset. The Company fully depreciated this intangible asset given that it is no longer using the technology provided by this vendor. Accordingly, the entire remaining balance of \$0.3 million was expensed.

Amortization expense of intangibles totaled \$1,172 and \$1,076 during the three months, and \$2,451 and \$2,344 during the six months ended June 30, 2012 and 2011, respectively.

Future estimated amortization costs of intangible assets as of June 30, 2012 are presented below:

Remainder of 2012	\$825
2013	1,479
2014	725
2015	709
	\$3,738

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4. Financial Instruments and Fair Value Measurements

The cost and fair value of the Company's available-for-sale investments as of June 30, 2012 and December 31, 2011 were as follows:

	June 30, 2012			
	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
Cash and Cash Equivalents:				
Cash	\$6,978	\$—	\$—	\$6,978
Money market funds	37,180	—	—	37,180
Commercial paper	1,999	—	—	1,999
Total	\$46,157	\$—	\$—	\$46,157
Short term investments:				
Corporate debt securities	\$25,187	\$1	\$(12)	\$25,176
Commercial paper	7,983	—	—	7,983
Certificates of deposit	2,038	—	—	2,038
Total	\$35,208	\$1	\$(12)	\$35,197
	December 31, 2011			
	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
Cash and Cash Equivalents:				
Cash	\$2,917	\$—	\$—	\$2,917
Money market funds	6,850	—	—	6,850
Total	\$9,767	\$—	\$—	\$9,767
Short term investments:				
Corporate debt securities	\$2,650	\$—	\$(3)	\$2,647
Commercial paper	300	—	—	300
Total	\$2,950	\$—	\$(3)	\$2,947

As of June 30, 2012 and December 31, 2011, all investments mature in less than one year. Estimated fair values for marketable securities are based on quoted market prices for the same or similar instruments.

Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., the "exit price") in an orderly transaction between market participants at the measurement date. A hierarchy for inputs used in measuring fair value has been defined to minimize the use of unobservable inputs by requiring the use of observable market data when available. Observable inputs are inputs that market participants would use in pricing the asset or liability based on active market data. Unobservable inputs are inputs that reflect the Company's assumptions about the assumptions market participants would use in pricing the asset or liability based on the best information available in the circumstances.

The fair value hierarchy prioritizes the inputs into three broad levels:

Level 1: Quoted (unadjusted) prices in active markets for identical assets or liabilities.

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The Company's Level 1 assets generally consist of money market funds.

Level 2: Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities 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 asset or liability.

The Company's Level 2 assets and liabilities generally consist of corporate bonds and agency debt securities, commercial paper, and certificates of deposit.

Level 3: Unobservable inputs to the valuation methodology that are supported by little or no market activity and that are significant to the measurement of the fair value of the assets or liabilities. Level 3 assets and liabilities include those whose fair value measurements are determined using pricing models, discounted cash flow methodologies or similar valuation techniques, as well as significant management judgment or estimation.

The Company's Level 3 liabilities have historically consisted of the Series B preferred stock warrants, which were exercised during the year ended December 31, 2011.

The following tables summarize, for each category of assets or liabilities, the respective fair value as of June 30, 2012 and December 31, 2011 and the classification by level of input within the fair value hierarchy.

	Balance as of June 30, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
Cash equivalents:				
Money market funds	\$ 37,180	\$ 37,180	\$ —	\$ —
Commercial paper	1,999	—	1,999	—
Short-term investments:				
Corporate debt securities	25,176	—	25,176	—
Commercial paper	7,983	—	7,983	—
Certificates of deposit	2,038	—	2,038	—
Total financial assets	\$ 74,376	\$ 37,180	\$ 37,196	\$ —

	Balance as of December 31, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
Cash equivalents:				
Money market funds	\$ 6,850	\$ 6,850	\$ —	\$ —
Short-term investments:				
Corporate debt securities	2,647	—	2,647	—
Commercial paper	300	—	300	—
Total financial assets	\$ 9,797	\$ 6,850	\$ 2,947	\$ —

5. Commitments and Contingencies

Operating Leases

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The Company leases certain of its facilities under noncancelable operating leases with various expiration dates through May 2017.

Rent expense was \$381 and \$374 for the three months and \$771 and \$696 for the six months ended June 30, 2012 and 2011, respectively.

Capital Leases

The Company acquired capital leases as part of the EDN acquisition. The leases were secured by fixed assets primarily used in a data center. The leases have various expiration dates through October 2012. The interest rates range from 2.9% to 9.7%.

At June 30, 2012, future annual minimum lease payments under noncancelable operating and capital leases were as follows:

	Capital Leases	Operating Leases
2012 remainder	\$11	\$2,686
2013	—	3,052
2014	—	1,064
2015	—	608
Total minimum lease payments	11	\$7,410
Less: Amount representing interest	(3)
Present value of capital lease obligations	8	
Less: Current portion	(8)
Long-term portion of capital lease obligations	\$—	

Contingencies

Under the indemnification provisions of the Company's customer agreements, the Company agrees to indemnify and defend and hold harmless its customers against, among other things, infringement of any patent, trademark or copyright under any country's laws or the misappropriation of any trade secret arising from the customers' legal use of the Company's solutions. The exposure to the Company under these indemnification provisions is generally limited to the total amount paid by the customers under the applicable customer agreement. However, certain indemnification provisions potentially expose the Company to losses in excess of the aggregate amount paid to the Company by the customer under the applicable customer agreement. To date, there have been no claims against the Company or its customers pursuant to these indemnification provisions.

Legal Contingencies

From time to time, the Company is involved in claims and legal proceedings that arise in the ordinary course of business. Based on currently available information, management does not believe that the ultimate outcome of these unresolved matters, individually and in the aggregate, is likely to have a material adverse effect on the Company's financial position, results of operations or cash flows. However, litigation is subject to inherent uncertainties and the Company's view of these matters may change in the future. Were an unfavorable outcome to occur, there exists the possibility of a material adverse impact on the Company's financial position, results of operations or cash flows for the period in which the unfavorable outcome occurs, and potentially in future periods.

The Company determined that subsequent to its acquisition of Fortiva, Inc., a Canadian company, in August 2008, it shipped a particular hardware appliance model to a limited number of international customers that, prior to shipment, required either a one-time product review or application for an encryption registration number in lieu of such product review. The Company has made voluntary submissions to the United States Commerce Department's Bureau of Industry and Security (BIS) to report this potential violation. Based upon the results of the internal investigation completed to date, the Company does not

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believe that the amount of any loss incurred as a result of this matter would be material to its business, financial condition, results of operations or cash flows.

As part of a pre-IPO due diligence review, the Company discovered a potential export violation involving the provision of web-based, email communication services through its Everyone.net service, which the Company acquired in October 2009. The Company's records indicate that there were two end-users who may have, for a portion of their respective service periods, been located in Iran, a United States designated state sponsor of terrorism. The Company's internal investigation has progressed and the Company has found that the issues identified are specific to the acquired Everyone.net system, which has a separate customer database and billing system from that of Proofpoint's main businesses. The Company does not have any indication that these services were utilized by the Iranian government. The accounts of both end-users were terminated in 2010 and accounted for approximately \$15 in payments to us in 2009 and \$6 in payments to us in 2010. Although the Company has ceased providing the service, the Company has made voluntary submissions to the U.S. Department of Treasury's Office of Foreign Assets Control, or OFAC, to report this potential violation. Based upon the results of the internal investigation completed to date, the Company does not believe that the amount of any loss incurred as a result of this matter would be material to its business, financial condition, results of operations or cash flows.

6. Debt

Equipment Financing Loans

The Company entered into a new equipment loan agreement with Silicon Valley Bank in April 2011 for an aggregate loan principal amount of \$6,000. Interest on the advances are equal to prime rate plus 0.50%. As of June 30, 2012, the interest on the advances was 4.50%. The Company had the ability to draw down on this equipment line through April 19, 2012. Each drawn amount is due 48 months after funding. Borrowings outstanding under the equipment loan at June 30, 2012 were \$4,788. Equipment financed under this loan arrangement is collateralized by the respective assets underlying the loan. The terms of the loan restrict the Company's ability to pay dividends. The loan includes a covenant that requires the Company to maintain cash and cash equivalents plus net accounts receivable of at least two times the amount of all outstanding indebtedness. As of June 30, 2012, the Company was in compliance with the financial covenant.

The Company had a previous equipment loan arrangement with Silicon Valley Bank for \$2,000. The loan bore interest at an annual rate of 8.75%. The maturity date was 36 months after the funding date. Borrowings outstanding under the equipment loan at June 30, 2011 were \$0, as the loan was completely repaid and closed in June 2011. Equipment financed under this loan arrangement was collateralized by the respective assets underlying each specific draw down. This loan required the Company to maintain a tangible net worth greater than \$18,000 and during the term of the loan, the Company was in compliance with the financial covenant.

Interest expense was \$57 and \$1 for the three months ended, and \$109 and \$2 for the six months ended June 30, 2012 and 2011, respectively.

At June 30, 2012, the remaining repayment commitments related to the equipment loans are as follows:

2012 remainder	\$820
2013	1,642
2014	1,642
2015	684
2016	—
	\$4,788

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7. Stockholders' Equity

Initial Public Offering

In April 2012, the Company completed its initial public offering of its common stock to the public ("IPO") whereby 5,859 shares of common stock sold by the Company (inclusive of 729 shares of common stock from the exercise of the overallotment option of shares granted to the underwriters) and 1,370 shares of common stock sold by the selling shareholders (inclusive of 171 shares of common stock from the partial exercise of the overallotment option granted to the underwriters). The public offering price of the shares sold in the offering was \$13.00 per share. The Company did not receive any proceeds from the sales of shares by the selling stockholder. The total gross proceeds from the offering to the Company were \$76.2 million. After deducting underwriters' discounts and commissions and offering expenses, the aggregate net proceeds received by the Company totaled approximately \$68.3 million. Immediately prior to the closing of the IPO, all shares of the Company's outstanding redeemable convertible preferred stock automatically converted into 19,567 shares of common stock. As a result, following the IPO, the Company has two classes of authorized stock: Common stock and Preferred stock.

As of June 30, 2012, the Company is authorized to issue two classes of stock totaling 205,000 shares, of which 5,000 are designated as preferred stock and 200,000 are designated common stock, each with a par value of \$0.0001 per share.

On March 30, 2012, the Company's Board of Directors approved a 1-for-2 reverse stock split of the Company's common stock. The reverse stock split became effective on April 2, 2012. All of the share numbers, share prices, and exercise prices have been retrospectively adjusted to reflect the reverse stock split.

The following table presents the shares authorized and issued and outstanding as of the dates presented (in thousands, except share data):

	As of June 30, 2012		As of December 31, 2011		Liquidation Amount
	Shares Authorized	Outstanding	Shares Authorized	Outstanding	
Convertible preferred stock Series A	—	—	7,400	7,400	7,400
Convertible preferred stock Series B	—	—	7,109	7,080	9,062
Convertible preferred Series C	—	—	8,307	8,307	20,020
Convertible preferred Series D	—	—	665	665	2,001
Convertible preferred Series E	—	—	5,743	5,743	20,001
Convertible preferred Series F	—	—	10,200	9,747	51,854
Common Stock	200,000	31,795	71,400	4,961	—
Undesignated preferred stock	5,000	—	—	—	—
	205,000	31,795	110,824	43,903	110,338

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Number of shares of common stock reserved for future issuance was as follows:

	As of June 30, 2012	As of December 31, 2011
Options available for future grant under the stock plans	5,180	364
Options outstanding under stock option plans	10,194	10,705
Shares available for future issuance under ESPP	745	—
Conversion of convertible preferred stock	—	39,134
Common stock issuable upon exercise of warrant and settlement of outstanding restricted stock units	23	25
Total shares reserved	16,142	50,228

Stock Option Plan

On March 30, 2012, the Board of Directors and the Company's shareholders approved the 2012 Equity Incentive Plan (the "2012 Plan"), which become effective on the first day that the Company's common stock is publicly traded. The Company has two equity incentive plans: the Company's 2002 stock option plan (the "2002 Plan") and the 2012 Equity Incentive Plan. In April 2012, the Company terminated the 2002 Plan and provided that no further stock awards were to be granted under the 2002 Plan and adopted the 2012 Plan as a continuation of and successor to the 2002 Plan.

Upon the IPO, all shares that were reserved under the 2002 Plan but not issued, and shares issued but subsequently returned to the plan through forfeitures, cancellations and repurchases were assumed by the 2012 Plan and no further shares will be granted pursuant to the 2002 Plan. All outstanding stock awards under the 2002 and 2012 Plans will continue to be governed by their existing terms. Under the 2012 Plan, the Company has the ability to issue incentive stock options ("ISOs"), nonstatutory stock options ("NSOs"), restricted stock awards, stock bonus awards, stock appreciation rights ("SARs"), restricted stock units ("RSUs"), and performance shares. The Plans also allow direct issuance of common stock to employees, outside directors and consultants at prices equal to the fair market value at the date of grant of options or issuance of common stock. Additionally, the 2012 Plan provides for the grant of performance cash awards to employees, directors and consultants. The Company has the right to repurchase any unvested shares (at the option exercise price) of common stock issued directly or under option exercises. The right of repurchase generally expires over the vesting period.

Under the Plans, the term of an option grant shall not exceed ten years from the date of its grant and options generally vest over a three to four-year period, with vesting on a monthly or annual interval. 20,316 shares of common stock are reserved for issuance to eligible participants, under the 2002 and 2012 Plans. As of June 30, 2012, 5,180 shares were available for future grant. Restricted stock awards generally vest over a four-year period with 25% vesting at the end of one year and the remaining vest quarterly thereafter. The number of shares available for grant and issuance under the 2012 Equity Plan will be increased automatically on January 1 of each of 2013 through 2016 by an amount equal to 5% of the Company's shares outstanding on the immediately preceding December 31, but not to exceed 3,724 shares, unless the Board of Directors, in its discretion, determines to make a smaller increase.

Employee Stock Purchase Plan

On March 30, 2012, the Board of Directors and the Company's shareholders approved the 2012 Employee Stock Purchase Plan (the "ESPP"), which become effective on the first day that the Company's common stock is publicly traded. A total of 745 shares of the Company's common stock are initially reserved for future issuance under the ESPP. The number of shares reserved for issuance under the ESPP will increase automatically on January 1 of each of the first eight years commencing with 2013 by the number of shares equal to 1% of the Company's shares outstanding on the immediately preceding December 31, but not to exceed 1,490 shares, unless the Board of Directors, in its discretion, determines to make a smaller increase. As of June 30, 2012 there remains 745 shares of the Company's common stock available for future issuance under the ESPP.

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Activity under the Plan was as follows:

	Shares subject to Options Outstanding		Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
	Number of Shares	Weighted Average Exercise Price		
Balance at December 31, 2011	10,705	\$3.83	6.77	\$44,466
Options granted	1,328	9.13		
Options exercised	(1,407)	1.26		
Options forfeited and canceled	(432)	5.49		
Balance at June 30, 2012	10,194	\$4.80	7.39	\$123,846

The total intrinsic value of options exercised was \$9,783 and \$1,505, for the six months ended June 30, 2012, and for the year ended December 31, 2011 respectively. Total cash proceeds from such option exercises were \$1,780 and \$1,198 for the six months ended June 30, 2012, and for the year ended December 31, 2011, respectively.

Restricted Stock Units

In December 2011, the Company assumed NextPage's 2007 Stock Plan (the "2007 Plan"). Under the 2007 Plan, the Company assumed 23 RSUs, which remain subject to their original terms and conditions.

During the year ended December 31, 2011, the Company acquired NextPage, Inc. and assumed the RSUs granted to certain employees. The fair value of each unit is based on the fair value of the Company's common stock on the date of assumption. A summary of the status of RSUs awarded and unvested under the stock option plans as of June 30, 2012 is presented below (in thousands, except per share amounts):

	RSUs Outstanding		Granted Fair Value Per Unit
	Number of Shares		
Awarded and unvested at December 31, 2011	8		\$7.98
Awards assumed	—		7.98
Awards vested	(4	)	7.98
Awards forfeited	(1	)	7.98
Awarded and unvested at June 30, 2012	3		\$7.98

As of June 30, 2012, there was \$22 of unamortized stock based compensation expense related to unvested RSUs, which are expected to be recognized over a weighted average period of 0.62 years.

8. Stock Based Compensation

The Company recognized stock-based compensation expense under the Plan in the consolidated statements of operations as follows (in thousands):

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Cost of subscription revenue	\$ 109	\$ 107	\$ 238	\$ 205
Cost of hardware and services revenue	15	6	26	13
Research and development	485	283	907	561
Sales and marketing	820	478	1,471	907
General and administrative	506	239	794	484
Total stock-based compensation expense	\$ 1,935	\$ 1,113	\$ 3,436	\$ 2,170

The fair value of options granted is estimated on the grant date using the Black Scholes option valuation model. This valuation model for stock based compensation expense requires the Company to make assumptions and judgments about the variables used in the calculation, including the expected term (weighted average period of time that the options granted are expected to be outstanding), the volatility of the common stock price, an assumed risk-free interest rate and the estimated forfeitures of unvested stock options. To the extent actual forfeitures differ from the estimates, the difference will be recorded as a cumulative adjustment in the period estimates are revised. No compensation cost is recorded for options that do not vest and the compensation cost from vested options, whether forfeited or not, is not reversed.

Prior to the Company's IPO, the Board of Directors, in good faith, determined the fair market values of the Company's common stock, based on the best information available to the Board and the Company's management at the time of grant. The Company performed its analysis in accordance with applicable elements of the practice aid issued by the American Institute of Certified Public Accountants entitled Valuation of Privately Held Company Equity Securities Issued as Compensation. The procedures performed to determine the fair value of the Company's common stock was based on a probability weighted expected return method to estimate the aggregate equity value of the Company. The weighted average fair value of stock options granted to employees was \$11.11 and \$5.48 during the three months ended, and \$9.13 and \$5.47 during the six months ended June 30, 2012 and 2011, respectively. The fair values were estimated on the grant dates using the Black Scholes option pricing model with the following weighted average assumptions:

	Three Months ended June 30,		Six Months ended June 30,	
	2012	2011	2012	2011
Expected life (in years)	6.08	6.08	6.08	6.08
Volatility	59%	59%	59-60%	59-60%
Risk-free interest rate	1.02%	2.2%	1.0-1.2%	2.2-2.5%
Dividend yield	—%	—%	—%	—%

The estimate for expected life of options granted reflects the midpoint of the vesting term and the contractual life computed utilizing the simplified method outlined in SEC's Staff Accounting Bulletin, or SAB, No. 107, Share Based Payment, or SAB 107. The Company does not have significant historical share option exercise experience and hence considers the expected term assumption calculated using the simplified method to be reasonable. Since the Company's stock is not publicly traded, the stock volatility assumptions represent an estimate of the historical volatilities of the common stock of a group of publicly traded peer companies that operate in a similar industry. The estimate was determined based on the average historical volatilities of these peer companies. The risk-free interest rate used was the Federal Reserve Bank's constant maturities interest rate commensurate with the expected life of the options in effect at the time of the grant. The expected dividend yield was zero, as the Company does not anticipate paying a dividend within the relevant time frame. Expected forfeitures are estimated based on the Company's historical experience. The Company realized no income tax benefit from stock option exercises in each of the periods presented due to recurring losses and defined tax asset valuation allowances.

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As of June 30, 2012, the Company had unamortized stock based compensation expense of \$13,756 related to stock options, that will be recognized net of forfeitures over the average remaining vesting term of the options of 2.84 years. The fair value of the option component of the ESPP shares was estimated at the grant date using the Black-Scholes option pricing model with the following weighted average assumptions:

	Three Months ended June 30, 2012
Expected volatility	51%
Risk-free interest rate	0.13%
Dividend yield	—%
Expected life (in years)	0.53

As of June 30, 2012, we expect to recognize \$337 of the total unamortized compensation cost related to employee purchases under the ESPP over a weighted average period of 0.34 years.

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9. Net Loss per Share

Basic net loss per share of common stock is calculated by dividing the net loss by the weighted average number of shares of common stock outstanding for the period. The weighted average number of shares of common stock used to calculate our basic net loss per share of common stock excludes those shares subject to repurchase related to stock options that were exercised prior to vesting as these shares are not deemed to be issued for accounting purposes until they vest. Diluted net loss per share of common stock is computed by dividing the net loss using the weighted average number of shares of common stock, excluding common stock subject to repurchase, and, if dilutive, potential shares of common stock outstanding during the period. Basic and diluted net loss per common share was the same for all periods presented as the impact of all potentially dilutive securities outstanding was anti-dilutive.

The following table presents the calculation of basic and diluted net loss per share:

Three Months Ended June 30,		Six Months Ended June 30,	
2012	2011	2012	2011