Five9, Inc.
Form 10-Q
November 07, 2014
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014

OR

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

For the transition period from to

Commission File Number: 001-36383

Five9, Inc.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	94- 3394123
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

Bishop Ranch 8
4000 Executive Parkway, Suite 400
San Ramon, CA 94583
(Address of Principal Executive Offices) (Zip Code)
(925) 201-2000
(Registrant’s Telephone Number, Including Area Code)

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

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: x No: o

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

Large Accelerated Filer	o		Accelerated Filer	o
Non-accelerated filer	x	(Do not check if a smaller reporting Company)	Smaller Reporting Company	o

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

As of October 31, 2014, there were 48,879,313 shares of the Registrant’s common stock, par value $0.001 per share, outstanding.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which involve substantial risks and uncertainties. These statements reflect the current views of our senior management with respect to future events and our financial performance. These forward-looking statements include statements with respect to our business and our industry in general. Statements that include the words “expect,” “intend,” “plan,” “believe,” “project,” “forecast,” “estimate,” “ “should,” “anticipate” and similar statements of a future or forward-looking nature identify forward-looking statements for purposes of the federal securities laws or otherwise.

Forward-looking statements address matters that involve risks and uncertainties. Accordingly, there are or will be important factors that could cause our actual results to differ materially from those indicated in these statements. These factors include the information set forth under the caption “Risk Factors” and elsewhere in this report, including the following:

- our quarterly and annual results may fluctuate significantly, may not fully reflect the underlying performance of our business and may result in decreases in the price of our common stock;
- if we are unable to attract new clients or sell additional services and functionality to our existing clients, our revenue and revenue growth will be harmed;
- our recent rapid growth may not be indicative of our future growth, and even if we continue to grow rapidly, we may fail to manage our growth effectively;
- the markets in which we participate are highly competitive, and even if we do not compete effectively, our operating results could be harmed;
- if we fail to manage our technical operations infrastructure, our existing clients may experience service outages, our new clients may experience delays in the deployment of our solution and we could be subject to, among other things, claims for credits or damages;
- if our dollar-based retention rate declines, our revenues and gross margins could decrease, our net loss could increase and we may be required to spend more money to grow our client base to maintain our revenues;
- we sell our solution to larger organizations that require longer sales and implementation cycles and often demand more configuration and integration services or customized features and functions that we may not offer, any of which could delay or prevent these sales and harm our growth rates, business and operating results;
- because a significant percentage of our revenue is derived from existing clients, downturns or upturns in new sales will not be immediately reflected in our operating results and may be difficult to discern;
- we rely on third-party telecommunications and internet service providers to provide our clients and their customers with telecommunication services and connectivity to our cloud contact center software and any failure by these service providers to provide reliable services could subject us to, among other things, claims for credits or damages;
- we have a history of losses and we may be unable to achieve or sustain profitability; and
- we may not be able to secure additional financing on favorable terms, or at all, to meet our future capital needs.

The foregoing factors should not be construed as exhaustive and should be read together with the other cautionary statements included in this report. If one or more of these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, our actual results may differ materially from what we anticipate. You should not place undue reliance on our forward-looking statements. Any forward-looking statements you read in this report reflect our views as of the date of this report with respect to future events and are subject to these and other risks, uncertainties and assumptions relating to our operations, results of operations, growth strategy and liquidity. We undertake no obligation to update any forward-looking statements made in this report to reflect events or circumstances after the date of this report or to reflect new information or the occurrence of unanticipated events, except as required by law.

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PART I. FINANCIAL INFORMATION
ITEM 1. Financial Statements
FIVE9, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited, in thousands, except per share data)

	September 30, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$53,489	$17,748
Short-term investments	29,999	—
Accounts receivable, net	7,725	6,970
Prepaid expenses and other current assets	2,726	1,651
Total current assets	93,939	26,369
Property and equipment, net	12,117	11,607
Intangible assets, net	2,681	3,065
Goodwill	11,798	11,798
Other assets	1,339	3,439
Total assets	$121,874	$56,278
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable	$2,856	$4,306
Accrued and other current liabilities	7,778	5,929
Accrued federal fees	6,430	4,206
Sales tax liability	260	98
Revolving line of credit	12,500	—
Notes payable	3,112	1,522
Capital leases	4,988	4,857
Deferred revenue	4,991	4,375
Total current liabilities	42,915	25,293
Revolving line of credit — less current portion	—	12,500
Sales tax liability — less current portion	2,177	5,350
Notes payable — less current portion	23,526	7,095
Capital leases — less current portion	4,499	4,358
Convertible preferred and common stock warrant liabilities	—	3,935
Other long-term liabilities	607	715
Total liabilities	73,724	59,246
Commitments and contingencies (Note 10)		
Stockholders' equity (deficit):		
Convertible preferred stock, $0.001 par value; no shares authorized, issued and outstanding as of September 30, 2014; 125,115 shares authorized, 122,216 shares issued and outstanding as of December 31, 2013	—	53,734
Preferred stock, $0.001 par value; 5,000 shares authorized, no shares issued and outstanding as of September 30, 2014; no shares authorized, issued and outstanding as of December 31, 2013	—	—
Common stock, $0.001 par value; 450,000 shares authorized, 48,473 shares issued and outstanding as of September 30, 2014; 200,000 shares authorized, 5,494 shares issued and outstanding as of December 31, 2013	48	5

Additional paid-in capital	167,311	34,089
Accumulated other comprehensive income	1	—
Accumulated deficit	(119,210)	(90,796)
Total stockholders’ equity (deficit)	48,150	(2,968)
Total liabilities and stockholders’ equity (deficit)	$121,874	$56,278

See accompanying notes to condensed consolidated financial statements.

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FIVE9, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
(Unaudited, in thousands, except per share data)

	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Revenue	$25,869	$21,091	$74,828	$60,489
Cost of revenue	13,504	12,265	40,121	36,161
Gross profit	12,365	8,826	34,707	24,328
Operating expenses:				
Research and development	5,503	4,419	16,282	12,679
Sales and marketing	9,296	6,964	27,992	20,338
General and administrative	7,967	4,223	17,653	12,100
Total operating expenses	22,766	15,606	61,927	45,117
Loss from operations	(10,401)	(6,780)	(27,220)	(20,789)
Other income (expense), net:				
Change in fair value of convertible preferred and common stock warrant liabilities	—	(622)	1,745	(1,177)
Interest expense	(1,116)	(273)	(2,986)	(666)
Interest income and other	95	(15)	99	19
Total other income (expense), net	(1,021)	(910)	(1,142)	(1,824)
Loss before provision for income taxes	(11,422)	(7,690)	(28,362)	(22,613)
Provision for income taxes	13	45	52	69
Net loss	$(11,435)	$(7,735)	$(28,414)	$(22,682)
Net loss per share:				
Basic and diluted	$(0.24)	$(2.05)	$(0.84)	$(6.19)
Shares used in computing net loss per share:				
Basic and diluted	48,310	3,779	33,762	3,667
Comprehensive Loss:				
Net loss	$(11,435)	$(7,735)	$(28,414)	$(22,682)
Other comprehensive income:				
Change in unrealized gain on short-term investments, net of tax	1	—	1	—
Comprehensive loss	$(11,434)	$(7,735)	$(28,413)	$(22,682)

See accompanying notes to condensed consolidated financial statements.

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FIVE9, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, in thousands)

	Nine Months Ended	
	September 30, 2014	September 30, 2013
Cash flows from operating activities:		
Net loss	$(28,414)	$(22,682)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	4,858	2,902
Provision for doubtful accounts	43	29
Stock-based compensation	4,796	1,026
Loss on the disposal of property and equipment	1	5
Non-cash interest expense	210	—
Changes in fair value of convertible preferred and common stock warrant liabilities	(1,745)	1,177
Accretion of discounts on short-term investments	(5)	—
Changes in operating assets and liabilities:		
Accounts receivable	(744)	187
Prepaid expenses and other current assets	(981)	(545)
Other assets	(39)	(175)
Accounts payable	(1,018)	(306)
Accrued and other current liabilities	2,558	980
Accrued federal fees and sales tax liability	(787)	1,588
Deferred revenue	666	325
Other liabilities	(158)	67
Net cash used in operating activities	(20,759)	(15,422)
Cash flows from investing activities:		
Purchases of property and equipment	(478)	(301)
Restricted cash	(25)	—
Purchase of short-term investments	(29,993)	—
Proceeds from sale of short-term investments	—	2,490
Net cash provided by (used in) investing activities	(30,496)	2,189
Cash flows from financing activities:		
Net proceeds from initial public offering, net of payments for offering costs	71,459	—
Payments for deferred offering costs	—	(757)
Net proceeds from issuance of convertible preferred stock	—	21,794
Proceeds from exercise of common stock options and warrants	767	169
Proceeds from notes payable	19,561	—
Repayments of notes payable	(783)	(532)
Payments of capital leases	(4,008)	(3,292)
Proceeds from revolving line of credit	—	6,000
Repayments on revolving line of credit	—	(6,000)
Net cash provided by financing activities	86,996	17,382
Net increase in cash and cash equivalents	35,741	4,149
Cash and cash equivalents:		
Beginning of period	17,748	5,961
End of period	$53,489	$10,110
Non-cash investing and financing activities:		

Equipment obtained under capital lease	$4,512	$3,597
Equipment purchased and unpaid at period-end	3	17
Deferred initial public offering costs incurred but unpaid at period-end	—	160
Reclass of deferred initial public offering costs to additional paid-in capital	2,179	—
Net cashless exercise of preferred stock warrants to Series A-2 convertible preferred stock	509	—
Vesting of early exercised stock options	185	—
Reclass of warrants liabilities to additional paid-in capital upon initial public offering	2,647	—
Conversion of convertible preferred stock to common stock upon initial public offering	54,244	—
Conversion of accrued federal fees to note payable, net	—	3,953

See accompanying notes to the condensed consolidated financial statements.

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FIVE9, INC.
Notes to Condensed Consolidated Financial Statements (Unaudited)

1. Description of Business and Summary of Significant Accounting Policies

Five9, Inc. and its wholly-owned subsidiaries (the "Company") is a provider of cloud contact center software. The Company was incorporated in Delaware in 2001 and is headquartered in San Ramon, California. The Company has offices in Europe and Asia, which primarily provide research, development and client support services.

Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States ("GAAP") and applicable rules and regulations of the Securities and Exchange Commission ("SEC") regarding interim financial reporting. Certain information and note disclosures normally included in 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 the Company's prospectus (dated April 3, 2014) filed with the SEC pursuant to Rule 424(b) under the Securities Act of 1933 on April 4, 2014. All intercompany transactions and balances have been eliminated in consolidation.

Initial Public Offering

On April 9, 2014, the Company consummated its initial public offering ("IPO") and issued and sold 10,000,000 shares of common stock at a public offering price of $7.00 per share, less the underwriters' discount. In addition, on April 22, 2014, the Company consummated the sale of an additional 1,500,000 shares of common stock to the underwriters of the Company's IPO pursuant to the underwriters' exercise in full of their option to purchase 1,500,000 shares of common stock from the Company at the IPO price of $7.00 per share, less the underwriters' discount. The Company received aggregate proceeds of $74.9 million from the IPO after deducting underwriters' discounts and commissions of $5.6 million, but before deduction of offering expenses of approximately $4.2 million, of which $0.8 million had been paid by us prior to 2014 and the remaining $3.4 million had been paid in the first two quarters of 2014.

On April 3, 2014, a reverse stock split of the Company's then-outstanding common stock at a ratio of 4:1 was effected in connection with the IPO. Prior to such reverse stock split being effected, all outstanding convertible preferred stock elected to convert to common stock on a 1:1 basis. In addition, upon the conversion of the convertible preferred stock, the Company's outstanding convertible preferred stock warrants became warrants to purchase common stock and, upon the IPO, the Company's outstanding common stock warrant liabilities became indexed to the Company's common stock and accordingly have been reclassified to additional paid-in capital.

In this quarterly report on Form 10-Q, all information related to common stock, warrants to purchase common stock, stock awards and earnings per share has been retroactively adjusted to give effect to the 4:1 reverse stock split, without any change in the par value per share. Fractional shares resulting from the reverse stock split have been rounded down to the closest whole share. Information related to shares of common stock authorized for issuance, convertible preferred stock and warrants to purchase convertible preferred stock has not been retroactively adjusted for the reverse stock split as there was no change in capital structure for these shares.

Use of Estimates

The preparation of consolidated financial statements in accordance with GAAP 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 consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. The significant estimates made by management affect revenue, the allowance for doubtful accounts, intangible assets, including goodwill, loss contingencies, including the Company's accrual for federal fees and sales tax liability, accrued liabilities, stock-based compensation, fair value calculations of the convertible preferred and common stock warrant liabilities, provision for income taxes and uncertain tax positions. Management periodically evaluates such estimates and they are adjusted prospectively based upon such periodic evaluation. Actual results could differ from those estimates.

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Significant Accounting Policies

The Company’s significant accounting policies are disclosed in the prospectus (dated April 3, 2014) filed with the SEC pursuant to Rule 424(b) under the Securities Act of 1933 on April 4, 2014. During the nine months ended September 30, 2014, there were no changes to our significant accounting policies.

Recent Accounting Pronouncements

On August 27, 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update ("ASU") No. 2014-15, Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern. The new guidance requires management of public and private companies to evaluate whether there is substantial doubt about the entity’s ability to continue as a going concern and, if so, disclose that fact. Management will also be required to evaluate and disclose whether its plans alleviate that doubt. The standard will be effective for the Company's annual period ending December 31, 2016 and interim and annual periods thereafter. Early adoption is permitted. The Company does not expect that the requirement will have an impact on its financial position, results of operations or cash flows.

On May 28, 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard is effective for the Company's annual and interim reporting periods beginning January 1, 2017. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is evaluating the effect that ASU 2014-09 will have on its consolidated financial statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

In July 2013, the FASB issued ASU No. 2013-11 on the financial statement presentation of unrecognized tax benefits. The new guidance provides that a liability related to an unrecognized tax benefit would be presented as a reduction of a deferred tax asset for a net operating loss carryforward, a similar tax loss or a tax credit carryforward if such settlement is required or expected in the event the uncertain tax position is disallowed. The Company adopted the guidance prospectively in the quarter ended March 31, 2014, and such adoption did not have a material impact on the Company's condensed consolidated financial statements.

2. Fair Value Measurements

The Company carries certain financial assets and liabilities consisting of money market funds, certificates of deposit and its convertible preferred and common stock warrant liabilities at fair value on a recurring basis. Fair value is based on the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is estimated by applying the following hierarchy, which prioritizes the inputs used to measure fair value into three levels and bases the categorization within the hierarchy upon the lowest level of input that is available and significant to the fair value measurement:

Level 1 — Observable inputs which include unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 — Observable inputs other than Level 1 inputs, such as quoted prices for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

Level 3 — Unobservable inputs that are supported by little or no market activity and that are based on management’s assumptions, including fair value measurements determined by using pricing models, discounted cash flow methodologies or similar techniques.

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The fair value of assets and liabilities carried at fair value was determined using the following inputs (in thousands):

	September 30, 2014	
	Total	Level 1
Assets		
Short-term investments:		
U.S. Treasury bills	$29,999	$29,999

	December 31, 2013		
	Total	Level 1	Level 3
Assets			
Cash equivalents:			
Money market funds	$738	$738	$—
Liabilities			
Convertible preferred stock warrant liability	3,935	—	3,935

A reconciliation of the convertible preferred and common stock warrants measured and recorded at fair value on a recurring basis, using significant unobservable inputs (Level 3) is as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Balance as of beginning of period	$—	$2,534	$3,935	$1,979
Changes in fair value of convertible preferred stock warrants	—	622	(1,233)	1,177
Exercise of Series A-2 convertible preferred stock warrants	—	—	(509)	—
Issuance of common stock warrants in connection with debt agreement	—	—	966	—
Changes in fair value of common stock warrants	—	—	(512)	—
Reclassified to additional paid-in capital	—	—	(2,647)	—
Balance as of end of period	$—	$3,156	$—	$3,156

In connection with the Company's IPO, all outstanding convertible preferred stock converted to common stock. As a result, as of April 3, 2014, liabilities associated with the convertible preferred stock warrants have been reclassified to additional paid-in capital because all of these warrants to purchase convertible preferred stock have become warrants to purchase common stock. Further, all the liability-classified common stock warrants became indexed to the Company's own equity upon the IPO, resulting in reclassification of the liability to additional paid-in capital.

3. Cash, Cash Equivalents and Short-Term Investments

The Company classifies all investments with original maturities of three months or less from date of purchase as cash equivalents and all investments with original maturities of greater than three months from the date of purchase as short-term investments. The Company classifies its investments in marketable securities as available-for-sale at the time of purchase and as a result, classifies such investments, including securities with maturities beyond twelve months, as current assets in the accompanying condensed consolidated balance sheets. The carrying values of all of the Company’s short-term investments approximate fair value.

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Cash and cash equivalents consisted of the following (in thousands):

	September 30, 2014	December 31, 2013
Cash and cash equivalents:		
Cash	$53,489	$17,010
Money market funds	—	738
Total cash and cash equivalents	$53,489	$17,748

As of September 30, 2014, short-term investments consisted of the following (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Aggregate Fair Value
U.S. Treasury bills	$29,998	$1	$—	$29,999

As of September 30, 2014, the Company's short-term investments will mature in approximately 1 month.

Restricted Cash

As of September 30, 2014 and December 31, 2013, the Company had restricted cash of $0.7 million classified in other assets on the accompanying condensed consolidated balance sheets, which related to a letter of credit issued to the Company's landlord with respect to its lease obligation for its corporate headquarters in San Ramon, California. As of September 30, 2014 and December 31, 2013, the Company also had $0.1 million of restricted cash classified in other assets on the accompanying condensed consolidated balance sheet under a letter of credit related to an insurance policy.

4. Financial Statement Components

Accounts receivable, net consisted of the following (in thousands):

	September 30, 2014	December 31, 2013
Trade accounts receivable	$7,102	$6,430
Unbilled trade accounts receivable, net of advance client deposits	657	582
Allowance for doubtful accounts	(34)	(42)
Accounts receivable, net	$7,725	$6,970

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

	September 30, 2014	December 31, 2013
Computer and network equipment	$22,909	$18,851
Computer software	2,093	1,550
Development costs	285	285
Furniture and fixtures	991	792
Leasehold improvements	611	539
Property and equipment	26,889	22,017
Accumulated depreciation and amortization	(14,772)	(10,410)
Property and equipment, net	$12,117	$11,607

Depreciation and amortization expense associated with property and equipment was $1.5 million and $4.5 million for the three and nine months ended September 30, 2014, respectively, and $1.1 million and $2.9 million for the three and nine months ended September 30, 2013, respectively.

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Property and equipment capitalized under capital lease obligations consist primarily of computer and network equipment and were as follows (in thousands):

	September 30, 2014	December 31, 2013
Gross	$19,649	$15,123
Less: accumulated depreciation and amortization	(9,371)	(5,591)
Total	$10,278	$9,532

Accrued and other current liabilities consisted of the following (in thousands):

	September 30, 2014	December 31, 2013
Accrued expenses	$1,989	$2,453
Accrued compensation and benefits	5,789	3,476
Accrued and other current liabilities	$7,778	$5,929

5. Intangible Assets

The components of intangible assets, which were acquired in connection with the Company's acquisition of Face It, Corp., which we refer to as SoCoCare, a social engagement and mobile customer care solution provider, in October 2013, were as follows (in thousands):

	September 30, 2014			December 31, 2013		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	$2,460	$(335)	$2,125	$2,460	$(72)	$2,388
Customer relationships	520	(99)	421	520	(21)	499
Domain names	50	(10)	40	50	(2)	48
Non-compete agreements	140	(45)	95	140	(10)	130
Total	$3,170	$(489)	$2,681	$3,170	$(105)	$3,065

Amortization expense related to intangible assets was $0.1 million and $0.4 million for the three and nine months ended September 30, 2014, respectively. As of September 30, 2014, the expected future amortization expense for intangible assets was as follows (in thousands):

Period	Expected Future Amortization Expense
Remainder of 2014	$128
2015	512
2016	503
2017	465
2018	442
2019 and beyond	631
Total	$2,681

6. Short-Term and Long-Term Debt

Loan and Security Agreement

In March 2013, the Company entered into a loan and security agreement ("Loan and Security Agreement") with a lender for a revolving line of credit (the "Credit Facility") of up to $12.5 million. The Loan and Security Agreement is collateralized by substantially all the assets of the Company. Under the terms of the Credit Facility, the

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balance outstanding cannot exceed the lesser of (i) $12,500,000 or (ii) an amount equal to the Company's monthly recurring revenue for the three months prior multiplied by the average Dollar-Based Retention Rate over the prior twelve months, less the amount accrued for the Company's USF obligation (accrued federal fees). The Credit Facility carries a variable annual interest rate of the prime rate plus 1.25% and matures in March 2015. As of September 30, 2014, the full amount available under the Credit Facility of $12.5 million was outstanding and has been presented as part of 'Current liabilities' in the condensed consolidated balance sheets.

In connection with the Company's acquisition of SoCoCare in October 2013, the Company amended its Loan and Security Agreement and borrowed an additional $5.0 million under a term loan (the "Term Loan") to be used for acquisition-related costs. Monthly interest-only payments are due on the advance at the prime rate plus 1.50% through September 2014. Principal and interest payments are due in equal monthly installments from October 2014 through the maturity of the Term Loan in March 2017. In connection with the Term Loan, the Company issued a warrant to purchase 52,054 shares of its Series D-2 convertible preferred stock at an exercise price of $1.441 per share. The issuance date fair value of this warrant of $0.1 million was recorded as a discount against the debt and is being recognized as additional interest expense over the term of the loan. Upon the effectiveness of the Company's registration statement filed with the SEC and the effectiveness of the 4:1 reverse stock split on April 3, 2014, this warrant became a warrant to purchase 13,013 shares of common stock at an exercise price of $5.76 per share.

The Loan and Security Agreement contains certain covenants, including the requirement that the Company maintain $5.5 million of cash deposited with the lender for the term of the Loan and Security Agreement. The Company was in compliance with these covenants as of September 30, 2014. The Loan and Security Agreement remains senior to other debts, including the debt issued under the 2014 Loan and Security Agreement discussed below.

2014 Loan and Security Agreement

In February 2014, the Company entered into a loan and security agreement (the "2014 Loan and Security Agreement") with a syndicate of two lenders ("Lenders") for a term loan facility of $30.0 million. The Lenders agreed to provide the Company this term loan facility pursuant to the terms of promissory notes issued under this Loan Agreement. The term loan facility is available to the Company in tranches; the first tranche for $20.0 million was advanced upon the closing of the agreement and the remaining $10.0 million is available for drawdown by the Company until February 2015 in $1.0 million increments. During the month of February 2014, the Company borrowed the first tranche of $20.0 million and incurred $0.4 million in debt issuance costs. The term loan bears interest at a variable per annum rate equal to the greater of 10% or LIBOR plus 9%. Interest is due and payable on the last business day of each month during the term of the loan commencing in February 2014. Monthly principal payments are due beginning in February 2016 based on 1/60th of the outstanding balance at that time and will continue until all remaining principal outstanding under the term loan becomes due and payable in February 2019. The term loan is secured by substantially all the assets of the Company and is subordinate to the Loan and Security Agreement. All amounts outstanding under this loan facility have been disclosed as part of 'Notes payable' in the condensed consolidated balance sheet as of September 30, 2014.

In connection with entering into the 2014 Loan and Security Agreement, the Company issued to the Lenders warrants to purchase 177,865 shares of common stock at $10.12 per share, which vest and become exercisable, over a ten year term from the date of issuance, based on amounts drawn under the $30.0 million term loan facility. The exercise price of such warrants was subject to adjustment in the event of issuances of common stock by the Company at a price lower than the exercise price of such warrants any time prior to the date of effectiveness of the Company's IPO and other corporate actions. Therefore, upon issuance the warrants were classified as a liability to the Company, which has been reclassified to additional paid-in capital upon the Company's IPO at which time these warrants were indexed to the Company's common stock. Based on the drawdown of $20.0 million in February 2014, 118,577 shares of common stock issuable under the warrants vested and are exercisable by the Lenders. As of September 30, 2014, 59,288 shares of common stock issuable under the warrants pertaining to the undrawn $10.0 million remain unvested.

The fair value of the vested warrants of $1.0 million was recorded as a discount against the debt proceeds and is being recognized as additional interest expense over the term of the loan.

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Promissory Note

In July 2013, the Company issued a promissory note to the Universal Service Administrative Company ("USAC") for $4.1 million as a financing arrangement for that amount of accrued federal fees. The promissory note carries a fixed annual interest rate of 12.75% and is repayable in 42 equal monthly installments of principal and interest beginning in August 2013. As of September 30, 2014 and December 31, 2013, approximately $2.9 million and $3.7 million, respectively, of this promissory note was outstanding and is included as notes payable in the accompanying condensed consolidated balance sheets.

As of September 30, 2014 and December 31, 2013, the Company's outstanding debt is summarized as follows (in thousands):

	September 30, 2014	December 31, 2013
Notes payable	$27,912	$8,695
Less discount	(1,274)	(78)
Net carrying value of notes payable	26,638	8,617
Notes payable, current portion	3,112	1,522
Notes payable, less current portion	23,526	7,095
Revolving line of credit, current portion	12,500	—
Revolving line of credit, less current portion	—	12,500
Net carrying value of total debt	$39,138	$21,117
Total debt, current portion	15,612	1,522
Total debt, less current portion	23,526	19,595

Maturities of the Company's outstanding debt as of September 30, 2014 are as follows (in thousands):

Period	Amount to Mature
Remainder of 2014	$772
2015	15,680
2016	7,007
2017	4,620
2018	4,000
2019	8,333
Total	$40,412

7. Stockholders' Equity (Deficit)

Capital Structure

Prior to the IPO (Note 1), the Company had outstanding 75,643,683 shares of Series A-2 convertible preferred stock, 18,565,794 shares of Series B-2 convertible preferred stock, 12,903,226 shares of Series C-2 convertible preferred stock, and 15,269,294 shares of Series D-2 convertible preferred stock. Each share of convertible preferred stock was convertible into one share of common stock upon receipt of the required consent of preferred stockholders or upon consummation of a qualified IPO.

In March 2014, the Company's board of directors and stockholders adopted an amendment to the Company's certificate of incorporation to effect a reverse stock split of the Company's outstanding common stock at a ratio of 4:1. Accordingly, on April 3, 2014, the reverse stock split was effected such that, (i) each 4 shares of the then-outstanding common stock was reduced to one share of common stock; (ii) the number of shares issuable upon exercise of outstanding options and warrants to purchase common stock was proportionately reduced; and (iii) the exercise price of all outstanding warrants or stock options to purchase common stock was proportionately increased.

On April 3, 2014, immediately prior to the effectiveness of the Company’s registration statement filed with the SEC and the reverse stock split being effected, all shares of the Company's outstanding convertible preferred stock converted into common stock on a 1:1 basis. Upon the consummation of the IPO and the 4:1 reverse stock split on April 3, 2014, all then-outstanding convertible preferred stock converted into 30,595,477 shares of common stock.
In connection with the Company's IPO, the Company amended and restated its certificate of incorporation ("Amended and Restated Certificate of Incorporation"), pursuant to which the Company is authorized to issue 450,000,000 shares of common stock and 5,000,000 shares of preferred stock, both with a par value of $0.001 per share. The Amended and Restated Certificate of Incorporation was filed with the Delaware Secretary of State, and became effective on April 8, 2014.
As of September 30, 2014, there were 48,472,439 shares of common stock issued and outstanding and no shares of preferred stock issued and outstanding.
Common Stock Subject to Repurchase or Forfeiture
In connection with employment and service agreements entered into in connection with the Company’s acquisition of SoCoCare in October 2013 ("Acquisition Date"), the Company issued 118,577 shares of unvested restricted common stock, the vesting of which is contingent upon continuing employment or services and subject to forfeiture. The forfeiture rights for 50% of such shares lapsed during October 2014 and the remaining 50% will lapse on the second anniversary of the Acquisition Date. These shares were valued at $1.0 million, based on the Acquisition Date fair value of the Company’s common stock. This amount is being recorded as stock-based compensation on a straight-line basis over the two-year requisite service period. The 118,577 shares that are subject to forfeiture are included in issued and outstanding shares of common stock as of September 30, 2014 and December 31, 2013, respectively. For the three and nine months ended September 30, 2014, $0.2 million and $0.6 million, respectively, was included as stock-based compensation expense related to these shares.
In addition, the Company has the right to repurchase, at the original exercise price, unvested common shares issued pursuant to the early exercise of stock options upon termination of service of an employee. The consideration received for an early exercise of an unvested option is considered to be a deposit of the exercise price, and the related dollar amount is recorded as a liability. The liability is reclassified as equity as the award vests. As of September 30, 2014 and December 31, 2013, a liability of $15 thousand and $0.1 million related to 1,595 and 14,970 unvested shares of common stock, respectively, has been included in 'Accrued and other current liabilities' in the condensed consolidated balance sheets. These exercised but unvested shares were included in issued and outstanding shares of common stock as of September 30, 2014 and December 31, 2013.
Warrants
As of September 30, 2014, the Company had outstanding warrants to purchase 359,596 shares of common stock with a weighted-average exercise price of $5.59 per share, which expire on various dates between November 2016 and February 2024.
Prior to the IPO, the Company had outstanding Series A-2 and Series D-2 convertible preferred stock warrants and common stock warrants that were issued to certain investors and lenders in connection with its debt agreements.
Series A-2 Convertible Preferred Stock Warrants — Prior to the preferred stock conversion and the reverse stock split effected in connection with the Company’s IPO, the Company had outstanding warrants to purchase 1,335,041 shares of Series A-2 convertible preferred stock with an exercise price of $0.163 per share, which expire on various dates between February 2015 and June 2020.
In March 2014, warrants to purchase 175,582 shares of Series A-2 convertible preferred stock were fully exercised under the cashless exercise method available under the warrant. Upon such exercise, the Company issued 166,228 shares of Series A-2 convertible preferred stock. Consequently, these instruments were no longer accounted for as liabilities. These preferred stock warrants were remeasured to their fair value as of the exercise date and the applicable fair value related to these warrants of $0.5 million was reclassified from liability to 'Additional paid-in capital' in the condensed consolidated balance sheets.
Series D-2 Convertible Preferred Stock Warrants — Prior to the preferred stock conversion and the reverse stock split effected in connection with the Company’s IPO, the Company had an outstanding warrant to purchase

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52,054 shares of Series D-2 convertible preferred stock with an exercise price of $1.441 per share that expires in October 2023.

Upon the preferred stock conversion and the 4:1 reverse stock split on April 3, 2014, all then-outstanding Series A-2 and Series D-2 convertible preferred stock warrants became warrants to purchase 346,764 shares of common stock. Subsequent to the IPO and through September 30, 2014, warrants to purchase 165,040 shares of common stock, which were formerly warrants to purchase Series A-2 convertible preferred stock, were fully exercised, some of which pursuant to the cashless exercise method. Upon such exercises, the Company issued 161,979 shares of common stock.

Common Stock Warrants - As of December 31, 2013, the Company had outstanding warrants to purchase 7 shares of common stock with an exercise price of $3,800.00 per share, which expire on November 2016 and August 2017.

In February 2014, in connection with the 2014 Loan and Security Agreement, the Company issued warrants to purchase up to 177,865 shares of common stock, to the extent vested, with an exercise price of $10.12 per share, which expire in February 2024. In February 2014, these warrants were vested with respect to 118,577 shares of common stock.

Fair Value of Warrants

The Company estimates the fair value of each liability-classified warrant on the date of issuance and at each reporting date using the Black-Scholes option-pricing model and using the assumptions noted in the below table. Expected volatility is based upon the historical and implied volatility of a peer group of publicly traded companies. The expected term of warrants represents the contractual term of the warrants. The risk-free rate for the expected term of the warrants is based on the U.S. Treasury Constant Maturity at the time of issuance.

The fair value of the convertible preferred stock warrants and the liability-classified common stock warrants at April 3, 2014 and December 31, 2013 was determined using the Black-Scholes option-pricing model with the following assumptions:

	IPO Date April 3, 2014		December 31, 2013
Fair value of Series A-2 preferred stock	$1.75	(1)	$2.69
Fair value of Series D-2 preferred stock	$1.75	(1)	$2.81
Fair value of common stock	$7.00	(1)	*
Risk-free interest rate	0.13% to 2.73%		0.33% to 2.60%
Expected life	Remaining contractual life		Remaining contractual life
Expected dividends	—		—
Volatility	40% - 50%		45.0 %

(1) Fair value of the underlying stock is based on the Company's initial public offering price of $7.00 per share calculated on a pre-reverse split basis for preferred stock and post-reverse split basis for common stock.

* There were no liability-classified common stock warrants at December 31, 2013.

On April 3, 2014, upon the effectiveness of the Company's registration statement filed with the SEC for the IPO, the fair value of the Company’s convertible preferred stock warrants and liability-classified common stock warrants of $2.6 million was reclassified from liability to additional paid-in capital in the condensed consolidated balance sheets. Fair value of these warrants on the date of the re-classification was equal to their carrying value.

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Common Stock Reserved for Future Issuance

Shares of common stock reserved for future issuance related to outstanding equity awards, warrants, and employee equity incentive plans were as follows (in thousands):

	September 30, 2014
Stock options outstanding	6,968
Restricted stock units outstanding	545
Shares available for future grant under 2014 Plan	5,103
Shares available for future issuance under ESPP	880
Common stock warrants outstanding	360
Total shares of common stock reserved	13,856

Equity Incentive Plans

Prior to the IPO, the Company granted stock options under its Amended and Restated 2004 Equity Incentive Plan, as amended (the “2004 Plan”). The 2004 Plan was adopted in June 2004 and most recently amended in March 2014 to increase the total shares of common stock reserved for issuance to 11,982,832 to eligible employees, non-employee consultants and directors.

Under the terms of the 2004 Plan, the Company has the ability to grant incentive and nonstatutory stock options. Incentive stock options could only be granted to Company employees. Nonstatutory stock options could be granted to Company employees, directors and consultants. Such options are exercisable at prices, as determined by the board of directors, generally equal to the fair value of the Company’s common stock at the date of grant. Options granted to employees generally vest over a four-year period, with an initial vesting period of 12 months for 25% of the shares, and the remaining 75% of the shares vesting monthly on a ratable basis over the remaining 36 months. Options generally expire ten years after the grant date and are generally exercisable upon vesting. Vested options generally expire 90 days after termination of the optionee’s employment or relationship as a consultant or director, unless otherwise extended by the terms of the stock option agreement. Any unvested options or expired options are returned to the 2004 Plan.

In March 2014, the Company’s stockholders and the board of directors approved the 2014 Equity Incentive Plan (“2014 Plan”) and 5,300,000 shares of common stock were authorized for issuance under the 2014 Plan. In addition, on the first day of each year beginning in 2015 and ending in 2024, the 2014 Plan provides for an annual automatic increase to the shares reserved for issuance. The 2014 Plan became effective on April 3, 2014. Upon the Company’s IPO, no future grants will be made under the 2004 Plan. All shares reserved under the 2004 Plan became available for grant under the 2014 Plan. Any forfeited or expired shares that would otherwise return to the 2004 Plan after the IPO will instead return to the 2014 Plan.

The 2014 Plan allows the Company to grant stock options, restricted stock units ("RSU"), restricted stock awards, performance stock awards, stock appreciation rights, performance cash awards, and other stock awards. To date, the Company has granted stock options and RSUs under the 2014 Plan. Stock options are granted under the 2014 Plan in general at a price not less than 100% of the fair market value of the common stock on the date of grant and vest over four years. The Company's stock options expire ten years from the date of grant. Each RSU granted under the 2014 Plan represents a right to receive one share of the Company’s common stock when the RSU vests. RSUs generally vest over one to four years.

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Stock Options

A summary of the Company's stock option activities during the nine months ended September 30, 2014 is as follows (in thousands, except years and per share data):

	Number of Shares Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Outstanding as of December 31, 2013	7,633	$3.30		
Options granted (weighted average grant date fair value of $5.72 per share)	477	10.67		
Options exercised	(721)	1.08		
Options forfeited or expired	(421)	3.86		
Outstanding as of September 30, 2014	6,968	$4.00	6.77	$23,729

The Company has computed the aggregate intrinsic value amounts disclosed in the above table based on the difference between the original exercise price of the options and the fair market value of the Company's common stock of $6.54 as of September 30, 2014 for all in-the-money options outstanding. As of September 30, 2014, there was $9.9 million of unrecognized compensation cost related to unvested stock options, net of estimated forfeitures, which is expected to be recognized over a weighted-average period of 3.0 years.

Restricted Stock Units

The Company commenced granting RSUs to employees upon the effectiveness of the 2014 Plan on April 3, 2014. During the nine months ended September 30, 2014, 545,521 RSUs were granted with a weighted-average grant date fair value of $6.73 per share. As of September 30, 2014, there was $2.5 million of unrecognized compensation cost related to unvested RSUs, net of estimated forfeitures, which is expected to be recognized over a weighted-average period of 2.7 years.

Employee Stock Purchase Plan

In March 2014, the Company's stockholders and the board of directors adopted the 2014 Employee Stock Purchase Plan ("ESPP"), and the shares authorized for issuance thereunder. The ESPP became effective on April 3, 2014. Under the initial offering program ("Initial Offering Program") approved by the compensation committee of the Company's board of directors ("Compensation Committee"), the initial offering period ("Initial Offering Period") commenced on April 3, 2014 with two purchases on November 15, 2014 and May 15, 2015. For the Initial Offering Period, the purchase price of the shares is 85% of the lower of the Company's IPO price of $7.00 per share or the market price on the date of purchase. In October 2014, the Compensation Committee approved a new six-month offering period program under which each offering period will consist of one six-month purchase period with purchase date on or about May 15 or November 15 of each year. The first offering period under the New Offering Program ("New Offering Period") will commence on November 16, 2014, which coincides with the first day of the second purchase period of the Initial Offering Period. The Initial Offering Program will continue in accordance with its terms for the Initial Offering Period and will terminate when the second purchase of the Initial Offering Period is made on May 15, 2015. Eligible employees are allowed to either participate in the New Offering Period or stay with the Initial Offering Period, if they have participated, or both. On May 15, 2015, the total shares of common stock a participant is allowed to purchase under both offering periods is 1,500 shares.

The ESPP permits eligible employees to purchase shares of the Company's common stock through payroll deductions with up to 15% of their pre-tax earnings subject to certain Internal Revenue Code limitations. The purchase price of the shares is 85% of the lower of the fair market value of the Company's common stock on the first day of an offering period, except for the initial offering period, or the relevant purchase date. In addition, no participant may purchase more than 1,500 shares of common stock in each purchase period.

The number of shares of common stock reserved for issuance under the ESPP is 880,000 shares, which will increase automatically each year, beginning on January 1, 2015 and continuing through January 1, 2024, by the

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lesser of (i) 1% of the total number of shares of our common stock outstanding on December 31 of the preceding calendar year; (ii) 1,000,000 shares of common stock (subject to adjustment to reflect any split or combination of our common stock); or (iii) such lesser number as determined by the Company's board of directors.

As of September 30, 2014, no purchases had been made under the ESPP. As of September 30, 2014, there was $0.5 million of unrecognized compensation cost related to purchase rights under the ESPP, which is expected to be recognized over a weighted-average period of 0.6 years.

Stock-Based Compensation

Stock-based compensation expenses for the three and nine months ended September 30, 2014 and 2013 are as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Cost of revenue	$158	$51	$366	$127
Research and development	583	136	1,404	238
Sales and marketing	361	182	1,055	421
General and administrative	775	89	1,971	240
Total stock-based compensation	$1,877	$458	$4,796	$1,026

The Company recognizes stock-based compensation expense that is calculated based upon awards ultimately expected to vest and, thus, stock-based compensation expense is reduced for estimated forfeitures. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

All stock-based compensation for equity awards granted to employees and directors is measured based on the grant date fair value of the award. Prior to the IPO, the Company estimated the fair value of its common stock utilizing periodic contemporaneous valuations prepared by an independent third-party appraiser based upon several factors, including its operating and financial performance, progress and milestones attained in its business, and past sales of convertible preferred stock. Upon the effectiveness of the IPO, the fair value of the Company's common stock is the closing market price of the Company's common stock as of the measurement date.

The Company values RSUs at the fair value of the Company's common stock on the date of grant.

The Company estimates the fair value of each stock option and purchase right under the ESPP granted to employees on the date of grant using the Black-Scholes option-pricing model and using the assumptions noted in the below table. Expected volatility is based upon the historical volatility of a peer group of publicly traded companies. The expected term of options granted is estimated by taking the average of the vesting term and the contractual term of the option. The risk-free rate for the expected term of the awards is based on U.S. Treasury zero-coupon issues at the time of grant. The weighted-average assumptions used to value stock options and purchase rights under the ESPP granted during the three and nine months ended September 30, 2014 and 2013 were as follows:

Stock Options	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Expected term (years)	6.1	6.1	6.1	6.1
Volatility	55%	60%	56%	60%
Risk-free interest rate	1.8%	1.8%	1.8%	1.3%
Dividend yield	—	—	—	—

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ESPP	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Expected term (years)	#	*	0.8	*
Volatility	#	*	39%	*
Risk-free interest rate	#	*	0.1%	*
Dividend yield	#	*	—	*

There were no purchase rights granted under the ESPP in the three months ended September 30, 2014.
* The ESPP was effective on April 3, 2014.

8. Net Loss Per Share
Basic net loss per share is calculated by dividing net loss by the weighted average number of common shares outstanding during the period, and excludes any dilutive effects of employee stock-based awards and warrants. Diluted net income per share is computed giving effect to all potentially dilutive common shares, including common stock issuable upon exercise of stock options and warrants. As the Company had net losses for the three and nine months ended September 30, 2014 and 2013, all potential common shares were determined to be anti-dilutive.
The following table presents the calculation of basic and diluted net loss per share (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Net loss	$(11,435)	$(7,735)	$(28,414)	$(22,682)
Weighted-average shares used in computing basic and diluted net loss per share	48,310	3,779	33,762	3,667
Basic and diluted net loss per share	$(0.24)	$(2.05)	$(0.84)	$(6.19)

The following securities were excluded from the calculation of diluted net loss per share attributable to common stockholders because their effect would have been anti-dilutive for the periods presented (in thousands):

	September 30, 2014	September 30, 2013
Convertible preferred stock (on an as converted post reverse stock split basis)	—	30,554
Stock options	6,968	6,479
Restricted stock units	545	—
ESPP	383	—
Common stock warrants	360	—
Convertible preferred stock warrants (on an as converted post reverse stock split basis)	—	378
Common stock subject to repurchase or forfeiture	120	—
Total	8,376	37,411

9. Income Taxes
The provision for income taxes for the three and nine months ended September 30, 2014 was approximately $13 thousand and $0.1 million, respectively. The provision for income taxes for the three and nine months ended September 30, 2013 was approximately $45 thousand and $0.1 million, respectively. The provision for income taxes consisted primarily of foreign income taxes.

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For the three and nine months ended September 30, 2014 and 2013, the provision for income taxes differed from the statutory amount primarily due to state and foreign taxes currently payable, and the Company realized no benefit for current year losses due to maintaining a full valuation allowance against its domestic and foreign net deferred tax assets.

The realization of tax benefits of deferred tax assets is dependent upon future levels of taxable income, of an appropriate character, in the periods the items are expected to be deductible or taxable. Based on the available objective evidence, the Company does not believe it is more likely than not that the net deferred tax assets will be realizable. Accordingly, the Company has provided a full valuation allowance against the domestic and foreign net deferred tax assets as of September 30, 2014 and December 31, 2013. The Company intends to maintain the remaining valuation allowance until sufficient positive evidence exists to support a reversal of, or decrease in, the valuation allowance. During the three and nine months ended September 30, 2014, there have been no material changes to the total amount of unrecognized tax benefits.

10. Commitments and Contingencies

Commitments

The Company’s principal commitments consist of obligations under operating leases for office space and facilities in the United States, and agreements with third parties to provide colocation hosting and telecommunication usage services. These commitments as of December 31, 2013 are disclosed in the Company’s prospectus (dated April 3, 2014) filed with the SEC pursuant to Rule 424(b) under the Securities Act of 1933 on April 4, 2014, and did not change materially during the nine months ended September 30, 2014 except for the following agreements entered into in 2014.

In January 2014, the Company modified its corporate office lease to expand its existing space for an additional commitment of $0.6 million over the term of the original lease.

In June 2014, the Company entered into an agreement for colocation hosting services in the U.K. for a term of 36 months commencing in July 2014. This agreement requires the Company to make monthly payments over the service term in exchange for certain guarantees of network availability. The Company's total minimum future payment commitments under this agreement are $0.6 million.

During the nine months ended September 30, 2014, the Company acquired data center and network equipment and software under multiple capital leases. As of September 30, 2014, total minimum future payment commitments under these capital leases were approximately $4.6 million, of which $0.4 million is due in the fourth quarter of 2014, with the remainder due over approximately three years thereafter.

Universal Services Fund Liability

During the third quarter of 2012, the Company determined that based on its business activities, it is classified as a telecommunications service provider for regulatory purposes and it should make direct contributions to the federal Universal Service Fund and related funds ("USF") based on revenues it receives from the resale of interstate and international telecommunications services. Previously, the Company had believed that the telecommunications services were an integral part of an information service that the Company provides via its software and had instead made indirect USF contributions via payments to its wholesale telecommunications service providers. In order to comply with the obligation to make direct contributions, the Company has made a voluntary self-disclosure to the Federal Communications Commission (“FCC”) Enforcement Bureau and has registered with the USAC, which is charged by the FCC with administering the USF. The Company has filed exemption certificates with its wholesale telecommunications service providers in order to eliminate its obligation to reimburse such wholesale telecommunications service providers for their USF contributions calculated on services sold to the Company.

The Company’s registration with USAC subjects it to assessments for unpaid USF contributions, as well as interest thereon and civil penalties, due to its late registration and past failure to recognize its obligation as a USF contributor and as an international carrier. The Company will be required to pay assessments for periods prior to the Company’s registration. While the Company is in administrative proceedings before the FCC to limit such back assessments to the period 2008 through 2012, it is possible that it will be required to pay back assessments for the period from 2003 through 2007. The Company will also face a regulatory and contractual challenge in seeking recovery or credit for its

USF reimbursement payments previously made to its wholesale telecommunications service providers of up to $3.1 million as of September 30, 2014 and December 31, 2013. In October 2014, the FCC

Enforcement Bureau began to negotiate with the Company a consent decree and a civil penalty to conclude its investigation into the Company's 2008 - 2012 USF contribution and international carrier authorization compliance, which is discussed further in Note 12. In 2013, the Company began remitting required contributions on a prospective basis directly to USAC.

In July 2013, the Company and USAC agreed to a financing arrangement for the undisputed portion of the unpaid USF contributions and related interest for the periods 2008 through 2012 whereby the Company issued to USAC a promissory note payable in the amount of $4.1 million. The repayment terms of the promissory note payable are disclosed in Note 6. As of September 30, 2014, the balance of the promissory note payable was $2.9 million and included in the notes payable amounts on the condensed consolidated balance sheets. In addition to the promissory note payable, the Company had an accrued liability for the unpaid USF contributions and related interest and penalties of $4.4 million and $4.2 million included in accrued federal fees on the condensed consolidated balance sheets as of September 30, 2014 and December 31, 2013, respectively, of which $0.8 million pertains to periods prior to 2008. For the three and nine months ended September 30, 2014, the Company incurred expenses related to its USF obligations of $1.0 million and $3.0 million, respectively. For the three and nine months ended September 30, 2013, the Company incurred expenses related to its USF obligations of $1.1 million and $3.0 million, respectively. These expenses were recorded as a charge to cost of revenue. For the three and nine months ended September 30, 2014, the Company also recorded interest and penalty expenses of $0.1 million and $0.3 million as a charge to general and administrative, respectively, which were related to its unpaid USF obligations for the periods prior to 2013. In addition, for the three months ended September 30, 2014, the Company accrued a current liability of $2.0 million within accrued federal fees for a potential settlement with the FCC Enforcement Bureau and recorded a corresponding charge to general and administrative expense (see Note 12). During the three and nine months ended September 30, 2014, the Company has remitted to the USAC $1.0 million and $3.1 million, respectively, for its current period USF contributions. No amounts related to the potential recovery or credit of USF contributions paid by the Company to its wholesale telecommunications service providers were recognized in the accompanying condensed consolidated financial statements.

State and Local Taxes and Surcharges

State sales taxes on sales of subscriptions

During 2011, the Company conducted an analysis of the taxability of sales of its subscription services. It was determined that the Company’s activities may be asserted by a number of states to create nexus and thus an obligation to collect sales taxes on sales of subscriptions to clients in certain states. Prior to April 2012, the Company did not collect sales taxes related to these sales from its clients. Accordingly, the Company registered with all applicable states, paid past-due amounts and commenced collecting sales taxes from its clients and remitting such taxes to the applicable state taxing authorities in April 2012.

State and local taxes and surcharges on usage-based fees

During 2013, the Company further analyzed its activities and determined it may be obligated to collect and remit various state and local taxes and surcharges on its usage-based fees. The Company had not remitted state and local taxes on usage-based fees in any of the periods prior to 2014 and therefore accrued a sales tax liability for this contingency. In January 2014, the Company commenced paying such taxes and surcharges to certain state authorities. In June 2014, the Company commenced collecting state and local taxes or surcharges on usage-based fees from its clients on a current basis and remitting such taxes to the applicable state taxing authorities.

As of September 30, 2014 and December 31, 2013, the Company had an accrued state and local sales tax liability for this contingency of $2.2 million and $5.4 million, respectively. During the three and nine months ended September 30, 2014, the Company has remitted $0.2 million and $1.3 million, respectively, for its state and local taxes on usage-based fees related to the periods prior to June 2014. Excluding a credit of $2.8 million recorded in the second quarter of 2014 as discussed below, for the three and nine months ended September 30, 2014, the Company recognized general and administrative expense of $0.1 million and $0.9 million, respectively, related to its estimated sales tax liability on some usage-based fees, which was not being collected from its clients. For the three and nine months ended September 30, 2013, the Company recorded general and administrative expense related to its estimated sales tax liability on usage-based fees of $0.5 million and $1.5 million, respectively.

Reversal of contingent sales tax liability - In May 2014, the Company received a letter from a state revenue authority which concluded that the Company's services provided to customers in that specific state are not subject to that state's local taxes. As a result, the Company released $2.8 million of sales tax liability, including estimated

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interest charges, accrued progressively on a quarterly basis from 2011 through the first quarter of 2014 for that state as we believe that the risk of loss being incurred is no longer probable. The reversal has been recorded through the general and administrative expense caption in the condensed consolidated statements of operations and comprehensive loss. This release of liability reduced the Company's net loss per basic and diluted share by $0.08 for the nine months ended September 30, 2014.

The Company's estimate of the probable loss incurred under this contingency is based on analysis of the source location of its usage-based fees and the regulations and rules in each state.

Legal Matters

The Company is involved in various legal and regulatory matters arising in the normal course of business. In management's opinion, resolution of these matters is not expected to have a material impact on the Company's consolidated results of operations, cash flows, or its financial position. However, depending on the nature and timing of any such dispute, an unfavorable resolution of a matter could materially affect the Company's future consolidated results of operations, cash flows or financial position in a particular period.

The Company is currently involved in one lawsuit as a defendant. In April 2012, NobelBiz, Inc., a telecommunication solutions company, brought a patent infringement lawsuit in the U.S. District Court for the Eastern District of Texas against the Company seeking a permanent injunction, damages and attorneys' fees. The Company responded to the complaint and preliminary injunction request by asserting non-infringement and invalidity of the patent.

In March 2013, the court granted the Company's motion to transfer the case to the U.S. District Court for the Northern District of California subsequent to which the complainant amended its claim to include another related patent. The Company has responded to this amended claim by continuing to assert non-infringement and invalidity of the patents. During December 2013, the court in California held a status conference and subsequently held a claim construction hearing regarding the patents on August 22, 2014. The order regarding claim construction is pending. No trial date or further schedule is anticipated until after the court in California issues its ruling as to claim construction following the hearing. The Company has investigated the claims alleged in the complaint and believes that it has good defenses to the claims. Accordingly, the Company has not accrued a loss related to this matter as the Company does not believe that it is probable that a loss will be incurred.

The Company recognizes general and administrative expense for legal fees in the period the services are provided.

Indemnification Agreements

In the ordinary course of business, the Company may provide indemnifications of varying scope and terms to clients, vendors, lessors, business partners and other parties with respect to certain matters, including, but not limited to, losses arising out of breach of such agreements, services to be provided by the Company or from intellectual property infringement claims made by third parties. In addition, the Company has entered into indemnification agreements with its directors, officers and certain employees that require the Company, among other things, to indemnify them against certain liabilities that may arise by reason of their status or service as directors, officers or employees. No demands have been made upon the Company to provide indemnification under such agreements and thus there are no claims that the Company is aware of that would have a material effect on the Company's condensed consolidated balance sheets, condensed consolidated statements of operations and comprehensive loss, or condensed consolidated statements of cash flows.

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11. Geographical Information

The following table is a summary of revenues by geographic region based on client billing address and has been estimated based on the amounts billed to clients during the periods (in thousands).

	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
United States	$23,879	$19,128	$69,130	$53,554
International	1,990	1,963	5,698	6,935
Total revenue	$25,869	$21,091	$74,828	$60,489

The following table summarizes total property and equipment, net in the respective locations (in thousands).

	September 30, 2014	December 31, 2013
United States	$10,320	$11,079
International	1,797	528
Property and equipment, net	$12,117	$11,607

12. Subsequent Event

In connection with the Company's late registration with the USAC and past failure to recognize its obligation as a USF contributor and as an international carrier (Note 10), in October 2014, the FCC Enforcement Bureau began to negotiate with the Company a consent decree and a civil penalty to conclude its investigation into the Company's 2008 - 2012 USF contribution and international carrier authorization compliance. On October 28, 2014, the FCC Enforcement Bureau and the Company tentatively agreed on a $2.0 million civil penalty and are negotiating on a consent decree to resolve this matter. Principal payments of the civil penalty will likely be due to the U.S. Treasury over 36 months beginning in early 2015 under an installment payment plan to be further negotiated by the Company and the FCC Enforcement Bureau.

Based on the information that became available in October 2014, the Company believes that this probable loss existed and became reasonably estimable as of September 30, 2014. Therefore, the Company recorded general and administrative expense of $2.0 million for this probable loss for the three month period ended September 30, 2014 in the condensed consolidated financial statements and accrued a current liability of $2.0 million within 'Accrued federal fees' in the condensed consolidated balance sheet as of September 30, 2014.

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

You should read the following discussion in conjunction with the condensed consolidated financial statements and notes thereto included elsewhere in this report and our prospectus (dated April 3, 2014) filed with the SEC pursuant to Rule 424(b) under the Securities Act of 1933 on April 4, 2014. In addition to historical information, this discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 that involve risks and uncertainties that could cause our actual results to differ materially from our expectations. Factors that could cause such differences include, but are not limited to, those described in the section titled "Risk Factors" and elsewhere in this report.

Overview

We are a pioneer and leading provider of cloud software for contact centers, facilitating over three billion interactions between our more than 2,000 clients and their customers per year. We believe we achieved this leadership position through our expertise and technology, which has empowered us to help organizations of all sizes transition from legacy on-premise contact center systems to our cloud solution. Our solution, which is comprised of our Virtual Contact Center ("VCC") cloud platform and applications, allows simultaneous management and optimization of customer interactions across voice, chat, email, web, social media and mobile channels, either directly or through our application programming interfaces. Our VCC cloud platform routes each customer interaction to an appropriate agent resource, and delivers relevant customer data to the agent in real-time to optimize the customer experience. Unlike legacy on-premise contact center systems, our solution requires minimal up-front investment and can be rapidly deployed and adjusted depending on our client's requirements.

Since founding our business in 2001, we have focused exclusively on delivering cloud contact center software. We initially targeted smaller contact center opportunities with our telesales team and, over time, invested in expanding the breadth and depth of the functionality of our cloud platform to meet the evolving requirements of our clients. In 2009, we made a strategic decision to expand our market opportunity to include larger contact centers. This decision drove further investments in research and development and the establishment of our field sales team to meet the requirements of these larger contact centers. We believe this shift has helped us diversify our client base while significantly enhancing our opportunity for future revenue growth. To complement these efforts, we have also focused on building client awareness and driving adoption of our solution through marketing activities, which include internet advertising, digital marketing campaigns, social marketing, trade shows, industry events and telemarketing. In June 2014, we introduced our Summer Release 2014 that includes new native multichannel applications that support social, mobile, chat and email interactions. The new multichannel capabilities are powered by Five9 Connect, a unique intelligent technology layer that helps contact centers evaluate, prioritize and route requests. Additional major enhancements provide more mobility for supervisors and the enablement of customized monitoring and reporting.

We provide our solution through a SaaS business model with recurring subscriptions. We offer a comprehensive suite of applications delivered on our VCC cloud platform that are designed to enable our clients to manage and optimize interactions across inbound and outbound contact centers. We primarily generate revenue by selling subscriptions and related usage of our VCC cloud platform. We charge our clients monthly subscription fees for access to our solution, primarily based on the number of agent seats, as well as the specific functionalities and applications our clients deploy. We define agent seats as the maximum number of named agents allowed to concurrently access our solution. Our clients typically have more named agents than agent seats, and multiple named agents may use an agent seat, though not simultaneously. Substantially all of our clients purchase both subscriptions and related usage from us. A small percentage of our clients subscribe to our platform but purchase telephony usage directly from a wholesale telecommunications service provider. We do not sell telephony usage on a stand-alone basis to any client. The related usage fees are based on the volume of minutes for inbound and outbound interactions. We also offer bundled plans, generally for smaller deployments, whereby the client is charged a single monthly fixed fee per agent seat that includes both subscription and unlimited usage in the contiguous 48 states and, in some cases, Canada. We offer both annual and monthly contracts to our clients, with 30 days' notice required for changes in the number of agent seats. Our clients can use this notice period to rapidly adjust the number of agent seats used to meet their changing contact center volume needs, including to reduce the number of agent seats to zero. As a general matter, this means that a client can effectively terminate its agreement with us upon 30 days' notice. Our larger clients typically choose annual

contracts, which generally include an implementation and ramp period of several months. Fixed subscription fees (including bundled plans) are generally billed monthly in advance, while related usage fees are billed in arrears. For the three and nine months ended September 30, 2014, subscription and

related usage fees accounted for 97% of our revenue. For the three and nine months ended September 30, 2013, subscription and related usage fees accounted for 98% of our revenue. The remainder is comprised of professional services revenue from the implementation and optimization of our solution.

Our revenue increased to $25.9 million and $74.8 million for the three and nine months ended September 30, 2014, from $21.1 million and $60.5 million for the three and nine months ended September 30, 2013, respectively. Revenue growth has primarily been driven by new clients choosing to use our solution and to a lesser extent, existing clients gradually increasing the number of agent seats under subscription. For each of the three and nine months ended September 30, 2014 and 2013, no single client accounted for more than 10% of our total revenue. As of September 30, 2014, we had over 2,000 clients across multiple industries, with subscriptions ranging in size from fewer than 10 agent seats to approximately 900 agent seats.

On March 20, 2014, we experienced an extended interruption in service due to an issue with third-party equipment that affected our Santa Clara, California colocation facility. Many of our larger clients utilize our geographic-redundancy option and were successfully switched over to our Atlanta, Georgia colocation facility. However, our clients that remained in our Santa Clara, California colocation facility experienced an extended interruption in service. We had refunded a portion of the affected month’s subscription revenue in the form of service credits to certain of these affected clients. The total credits refunded relating to this interruption in service did not have a material impact on our revenue for the nine months ended September 30, 2014, and it did not impact revenue for the three months ended September 30, 2014 or revenue previously reported for any period prior to 2014.

In April 2014, we consummated our initial public offering, or IPO, in which we sold 11,500,000 shares of common stock (inclusive of 1,500,000 shares of common stock from the exercise of the option granted to the underwriters). The public offering price of the shares sold in the IPO was $7.00 per share. We received aggregate proceeds of $74.9 million from the IPO after deducting underwriters’ discounts and commissions of $5.6 million, but before deduction of offering expenses of approximately $4.2 million, of which $0.8 million had been paid by us prior to 2014 and the remaining $3.4 million had been paid in the first two quarters of 2014.

We have continued to make significant expenditures and investments, including in research and development, sales and marketing and infrastructure. We primarily evaluate the success of our business based on revenue growth and the efficiency and effectiveness of our investments.

The growth of our business and our future success depend on many factors, including our ability to continue to expand our client base to include larger opportunities, grow revenue from our existing client base, innovate and expand internationally. While these areas represent significant opportunities for us, they also pose risks and challenges that we must successfully address in order to sustain the growth of our business and improve our operating results. In order to pursue these opportunities, we anticipate that we will expand our operations and headcount in the near term. The expected addition of new employees and the investments that we anticipate will be necessary to manage our anticipated growth will make it more difficult for us to generate earnings. As we grow our business, we expect our cost of revenue and operating expenses to increase in future periods. For example, (i) sales and marketing expenses are expected to increase in absolute dollars as we continue to expand our sales and marketing teams, increase our marketing activities and grow our international operations; (ii) research and development expenses are expected to increase in absolute dollars to support the enhancement of our existing solution and development of additional industry-leading contact center features and applications; and (iii) general and administrative expenses are expected to increase in absolute dollars as a result of both our growth and the infrastructure required to be a public company. In order to support future client growth, we also intend to invest in maintaining a high level of client service and support and in our data center infrastructure and services capabilities. Due to our continuing investments to scale our business, increase our sales and marketing efforts, pursue new opportunities, enhance our solution and build our technology, we will continue to incur significant expenses in the future.

Key Operating and Financial Performance Metrics

In addition to measures of financial performance presented in our condensed consolidated financial statements, we monitor the key metrics set forth below to help us evaluate growth trends, establish budgets, measure the effectiveness of our sales and marketing efforts and assess operational efficiencies.

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Dollar-Based Retention Rate

We believe that our Dollar-Based Retention Rate provides insight into our ability to retain and grow revenue from our clients, and is a measure of the long-term value of our client relationships. Our Dollar-Based Retention Rate is calculated by dividing our Retained Net Invoicing by our Retention Base Net Invoicing on a monthly basis, which we then average using the rates for the trailing twelve months for the period being presented. We define Retention Base Net Invoicing as recurring net invoicing from all clients in the comparable prior year period, and we define Retained Net Invoicing as recurring net invoicing from that same group of clients in the current period. We define recurring net invoicing as subscription and related usage revenue excluding the impact of service credits, reserves and deferrals. Historically, recurring net invoicing has been within 10% of our subscription and related usage revenue.

The following table shows our Dollar-Based Retention Rate for the periods presented:

	Twelve Months Ended	
	September 30, 2014	September 30, 2013
Dollar-Based Retention Rate	97%	102%

Our Dollar-Based Retention Rate declined year over year primarily due to a reduction in usage revenue during the period from one current client due to the competitive pricing environment on international calling, and our termination of one large client in 2013 based on financial difficulties experienced by this client and its failure to comply with the terms of its contract.

Adjusted EBITDA

We monitor Adjusted EBITDA, a non-GAAP financial measure, to analyze our financial results and believe that it is useful to investors, as a supplement to U.S. GAAP measures, in evaluating our ongoing operational performance and enhancing an overall understanding of our past financial performance. We believe that Adjusted EBITDA helps illustrate underlying trends in our business that could otherwise be masked by the effect of the income or expenses that we exclude from Adjusted EBITDA. Furthermore, we use this measure to establish budgets and operational goals for managing our business and evaluating our performance. We also believe that Adjusted EBITDA provides an additional tool for investors to use in comparing our recurring core business operating results over multiple periods with other companies in our industry.

Adjusted EBITDA should not be considered in isolation from, or as a substitute for, financial information prepared in accordance with U.S. GAAP and our calculation of Adjusted EBITDA may differ from that of other companies in our industry. We compensate for the inherent limitations associated with using Adjusted EBITDA through disclosure of these limitations, presentation of our financial statements in accordance with U.S. GAAP and reconciliation of Adjusted EBITDA to the most directly comparable U.S. GAAP measure, net loss. We calculated Adjusted EBITDA as net loss before (1) depreciation and amortization, (2) stock-based compensation, (3) change in fair value of convertible preferred and common stock warrants, (4) interest expense, (5) interest income and other, (6) provision for income taxes, (7) a credit recorded in the three months ended June 30, 2014 to release a contingent sales tax liability that was accrued progressively on a quarterly basis from 2011 through the first quarter of 2014 following a favorable ruling from a state revenue authority, and (8) an FCC settlement charge recorded in the three months ended September 30, 2014.

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The following table shows a reconciliation from net loss to Adjusted EBITDA for the periods presented (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Net loss	$(11,435)	$(7,735)	$(28,414)	$(22,682)
Non-GAAP adjustments:				
Depreciation and amortization [1]	1,567	1,063	4,858	2,902
Stock-based compensation [2]	1,877	458	4,796	1,026
Interest expense	1,116	273	2,986	666
Interest income and other	(95)	15	(99)	(19)
Provision for income taxes	13	45	52	69
Change in fair value of convertible preferred and common stock warrant liabilities	—	622	(1,745)	1,177
Reversal of contingent sales tax liability [3]	—	—	(2,766)	—
Accrued FCC charge [4]	2,000	—	2,000	—
Adjusted EBITDA	$(4,957)	$(5,259)	$(18,332)	$(16,861)

(1) Depreciation and amortization expenses included in our results of operations are as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Cost of revenue	$1,272	$900	$3,847	$2,509
Research and development	58	57	154	155
Sales and marketing	50	17	146	42
General and administrative	187	89	711	196
Total depreciation and amortization	$1,567	$1,063	$4,858	$2,902

(2) See Note 7 of the notes to the condensed consolidated financial statements for stock-based compensation expense included in our results of operations for the periods presented.
(3) Included in general and administrative. See Note 10 of the notes to the condensed consolidated financial statements.
(4) Included in general and administrative. See Note 12 of the notes to the condensed consolidated financial statements.

Key Components of Our Results of Operations

Revenue

Our revenue consists of subscription and related usage as well as professional services. We consider our subscription and related usage to be recurring. This recurring revenue includes fixed subscription fees for the delivery and support of our VCC cloud platform as well as related usage fees. The related usage fees are based on the volume of minutes for inbound and outbound client interactions. We also offer bundled plans, generally for smaller deployments, whereby the client is charged a single monthly fixed fee per agent seat that includes both subscription and unlimited usage in the contiguous 48 states and, in some cases, Canada. We offer both annual and monthly contracts for our clients, with 30 days' notice required for changes in the number of agent seats. Our clients can use this notice period to rapidly adjust the number of agent seats used to meet their changing contact center volume needs, including to reduce the number of agent seats to zero. As a general matter, this means that a client can effectively terminate its agreement with us upon 30 days' notice.

Fixed subscription fees, including plans with bundled usage, are generally billed monthly in advance, while variable usage fees are billed in arrears. Fixed subscription fees are recognized on a straight-line basis over the applicable term, predominantly the monthly contractual billing period. Support activities include technical assistance for our solution and upgrades and enhancements on a when and if available basis, which are not billed separately. Variable subscription related usage fees for non-bundled plans are billed in arrears based on client specific per minute rate plans and are recognized as actual usage occurs. We generally require advance deposits from clients based on estimated usage. All fees, except usage deposits, are non-refundable.

In addition, we generate professional services revenue from assisting clients in implementing our solution and optimizing use. These services include application configuration, system integration and education and training services. Professional services are primarily billed on a fixed-fee basis and are typically performed by us directly. In limited cases, our clients may choose to perform these services themselves or engage their own third-party service providers to perform such services. Professional services are recognized as the services are performed using the proportional performance method, with performance measured based on hours of work performed provided all other criteria for revenue recognition are met.

Cost of Revenue

Our cost of revenue consists primarily of fees that we pay to telecommunications providers for usage, personnel costs (including stock-based compensation), costs to build out and maintain colocation data centers, depreciation and related expenses of the servers and equipment, and taxes due to federal and state agencies on usage fees. Personnel costs included as part of cost of revenue include those associated with support of our solution, clients and data center operations, as well as providing professional services. Cost of revenue can fluctuate based on a number of factors, including the fees we pay to telecommunications providers, which vary depending on our clients' usage of our VCC cloud platform, the timing of capital expenditures and related depreciation charges and changes in headcount. We expect to continue investing in our network infrastructure and operations and client support function to maintain high quality and availability of service. As our business grows, we expect to realize economies of scale in network infrastructure, personnel and client support.

Operating Expenses

We classify our operating expenses as research and development, sales and marketing and general and administrative expenses.

Research and Development. Our research and development expenses consist primarily of salary and related expenses (including stock-based compensation) for personnel related to the development of improvements and expanded features for our services, as well as quality assurance, testing, product management and allocated overhead. We expense research and development expenses as they are incurred. We believe that continued investment in our solution is important for our future growth, and we expect research and development expenses to increase in absolute dollars in the foreseeable future as we continue to hire additional personnel to update and enhance our solution, although these expenses may fluctuate as a percentage of our revenue from period to period.

Sales and Marketing. Sales and marketing expenses consist primarily of salaries and related expenses (including stock-based compensation) for employees in sales and marketing, including commissions and bonuses, as well as advertising, marketing, corporate communications, travel costs and allocated overhead. We expense the costs of sales commissions associated with the acquisition or renewal of client contracts as incurred in the period the contract is acquired or the renewal occurs. We believe it is important to continue investing in sales and marketing to continue to generate revenue growth. Accordingly, we expect sales and marketing expenses to increase in absolute dollars as we continue to support our growth initiatives, although these expenses may fluctuate as a percentage of our revenue from period to period.

General and Administrative. General and administrative expenses consist primarily of salary and related expenses (including stock-based compensation) for management, finance and accounting, legal, information systems and human resources personnel, professional fees, compliance costs, other corporate expenses and allocated overhead. Excluding a $2.8 million credit recorded in the second quarter of 2014 following a favorable ruling from a state's revenue authority (see Note 10 of the notes to our condensed consolidated financial statements) and a $2.0 million charge recorded in the third quarter of 2014 due to a potential settlement with the FCC Enforcement Bureau (see Note 12 of

the notes to our condensed consolidated financial statements), we expect that general and administrative expenses will generally increase in absolute dollars but decline as a percentage of revenue.

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Other Income (Expense), Net

Other income (expense), net consists primarily of interest expense associated with our notes payable, capital leases, and revolving line of credit. In October 2013, we borrowed a $5.0 million term loan to acquire SoCoCare. In December 2013, we drew down $12.5 million under our revolving line of credit. In February 2014, we borrowed a $20.0 million term loan under the 2014 Loan and Security Agreement. See Note 6 of the notes to the condensed consolidated financial statements.

Change in Fair Value of Convertible Preferred and Common Stock Warrant Liabilities. Prior to our IPO, we had outstanding warrants to purchase shares of our convertible preferred stock and common stock which were classified as liabilities. These warrants were subject to re-measurement at each balance sheet date, and any change in fair value was recognized as a component of other income (expense), net. In connection with our IPO in April 2014, these liability-classified warrants became equity-classified and accordingly the associated liability was reclassified to additional paid-in capital. After the IPO, we are no longer required to re-measure the fair value of the warrant liability, therefore, beginning with the three months ended June 30, 2014, no further charges or credits related to such warrants have been or will be made to other income (expense), net.

Provision for Income Taxes

Our provision for income taxes consists primarily of corporate income taxes resulting from profits generated in foreign jurisdictions by our wholly-owned subsidiaries, along with state income taxes payable in the United States.

Results of Operations for the Three and Nine Months Ended September 30, 2014 and 2013

Based on the condensed consolidated statements of operations and comprehensive loss set forth in this quarterly report, the following table sets forth our operating results as a percentage of revenue for the periods indicated:

	Three Months Ended				Nine Months Ended			
	September 30, 2014		September 30, 2013		September 30, 2014		September 30, 2013	
Revenue	100	%	100	%	100	%	100	%
Cost of revenue	52	%	58	%	54	%	60	%
Gross profit	48	%	42	%	46	%	40	%
Operating expenses:								
Research and development	21	%	21	%	22	%	21	%
Sales and marketing	36	%	33	%	37	%	33	%
General and administrative	31	%	20	%	23	%	20	%
Total operating expenses	88	%	74	%	82	%	74	%
Loss from operations	(40	)%	(32	)%	(36	)%	(34	)%
Other income (expense), net:								
Change in fair value of convertible preferred and common stock warrant liabilities	—	%	(3	)%	2	%	(2	)%
Interest expense	(5	)%	(1	)%	(4	)%	(1	)%
Interest income and other	1	%	—	%	—	%	—	%
Total other income (expense), net	(4	)%	(4	)%	(2	)%	(3	)%
Loss before provision for income taxes	(44	)%	(36	)%	(38	)%	(37	)%
Provision for income taxes	—	%	1	%	—	%	—	%
Net loss	(44	)%	(37	)%	(38	)%	(37	)%

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Revenue

	Three Months Ended				Nine Months Ended			
	September 30, 2014	September 30, 2013	$ Change	% Change	September 30, 2014	September 30, 2013	$ Change	% Change
	(in thousands, except percentages)							
Revenue	$25,869	$21,091	$4,778	23%	$74,828	$60,489	$14,339	24%

For the three and nine months ended September 30, 2014, approximately $4.5 million, or 93%, and $9.0 million, or 63%, respectively, of the increase in revenue was attributable to revenue from new clients acquired since October 1, 2013, which was primarily driven by an increase in sales and marketing activities in the twelve months ended September 30, 2014. For the three and nine months ended September 30, 2014, approximately $0.3 million, or 7%, and $5.3 million, or 37%, respectively, of the increase in revenue was attributable to revenue from existing clients as of September 30, 2013. Our average pricing remained relatively consistent between these periods.

Cost of Revenue

	Three Months Ended				Nine Months Ended			
	September 30, 2014	September 30, 2013	$ Change	% Change	September 30, 2014	September 30, 2013	$ Change	% Change
	(in thousands, except percentages)							
Cost of revenue	$13,504	$12,265	$1,239	10%	$40,121	$36,161	$3,960	11%
% of Revenue	52%	58%			54%	60%		

The increase in cost of revenue for the three and nine months ended September 30, 2014 compared to the same periods of 2013, respectively, was primarily due to a $0.6 million and a $1.8 million increase in personnel costs driven by increased headcount, a $0.3 million and a $0.8 million increase in facility-related costs due to expanded office space and increased headcount, a $0.3 million and a $1.1 million increase in depreciation expenses for servers and equipment due to additional investments in technical infrastructure to support current and expected future client growth, and a $0.2 million and a $0.3 million increase in business travel and related expenses, respectively. In addition, the increase for the nine months ended September 30, 2014 was also attributable to a $0.3 million increase in amortization of intangible asset related to developed technology that was acquired in connection with our acquisition of SoCoCare in October 2013, and a $0.2 million increase in stock-based compensation expense due to headcount additions, as well as the increased fair value of employee equity awards granted from period to period. These increases for the three and nine months ended September 30, 2014 were offset in part by a $0.2 million and a $0.8 million decrease, respectively, in telecommunication carrier costs relating to our clients' long distance call usage due to improved usage efficiencies. The remainder of the increases were primarily due to our business growth and system implementations.

Gross Profit

	Three Months Ended				Nine Months Ended			
	September 30, 2014	September 30, 2013	$ Change	% Change	September 30, 2014	September 30, 2013	$ Change	% Change
	(in thousands, except percentages)							
Gross profit	$12,365	$8,826	$3,539	40%	$34,707	$24,328	$10,379	43%
% of Revenue	48%	42%			46%	40%		

For the three and nine months ended September 30, 2014, the increase in gross margin was primarily due to improved usage efficiencies and continued benefit from economies of scale.

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Operating Expenses

Research and Development

	Three Months Ended				Nine Months Ended			
	September 30, 2014	September 30, 2013	$ Change	% Change	September 30, 2014	September 30, 2013	$ Change	% Change
	(in thousands, except percentages)							
Research and development	$5,503	$4,419	$1,084	25%	$16,282	$12,679	$3,603	28%
% of Revenue	21%	21%			22%	21%		

The increase in research and development expenses for the three and nine months ended September 30, 2014 compared to the same periods of 2013, was primarily due to a $0.7 million and a $2.6 million increase in personnel-related costs driven by an increase in average employee and related costs as we had more senior level employees during 2014 as compared with 2013 as part of our investment in future growth, and a $0.4 million and a $1.2 million increase in stock-based compensation expense due to an increase in the fair value of employee equity awards granted from period to period, respectively.

Sales and Marketing

	Three Months Ended				Nine Months Ended			
	September 30, 2014	September 30, 2013	$ Change	% Change	September 30, 2014	September 30, 2013	$ Change	% Change
	(in thousands, except percentages)							
Sales and marketing	$9,296	$6,964	$2,332	33%	$27,992	$20,338	$7,654	38%
% of Revenue	36%	33%			37%	33%		

The increase in sales and marketing expenses for the three and nine months ended September 30, 2014 compared to the same periods of 2013, respectively, was primarily due to a $0.9 million and a $3.2 million increase in personnel costs resulting from headcount additions, a $0.5 million and a $1.1 million increase in commissions paid to sales personnel driven by the growth in sales of our solution, a $0.3 million and a $1.3 million increase in marketing-related expenses, a $0.2 million and a $0.6 million increase in business travel and related expenses, a $0.2 million and a $0.6 million increase in facility and office-related costs due to expanded office space to support increased headcount, and a $0.2 million and a $0.6 million increase in stock-based compensation expense due to headcount additions, as well as the increased fair value of employee equity awards granted from period to period. The increases in headcount and other expense categories described above supported our growth strategy to acquire new clients, increase the number of agent seats within our existing client base and establish brand awareness. We increased marketing efforts to raise brand awareness and lead generation efforts, which led to increased marketing, travel and related expenses.

Sales and marketing expenses increased as a percentage of revenue, primarily as a result of expenses incurred in expanding our marketing organization and continuing to increase our field sales personnel.

General and Administrative

	Three Months Ended				Nine Months Ended			
	September 30, 2014	September 30, 2013	$ Change	% Change	September 30, 2014	September 30, 2013	$ Change	% Change
	(in thousands, except percentages)							
General and administrative	$7,967	$4,223	$3,744	89%	$17,653	$12,100	$5,553	46%
% of Revenue	31%	20%			23%	20%		

The increase in general and administrative expenses for the three and nine months ended September 30, 2014 compared to the same periods of 2013, was primarily due to a $2.0 million charge for a potential settlement with the

FCC Enforcement Bureau (see Note 12 of the notes to our condensed consolidated financial statements), a $1.2 million and a $3.5 million increase in personnel costs due to headcount additions as we prepared to become a public company, a $0.7 million and a $1.7 million increase in stock-based compensation expense due to headcount

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additions as well as the increased fair value of employee equity awards granted from period to period, a $0.1 million and $0.5 million increase in depreciation expense primarily for computer equipment and software due to additional headcount and investments in infrastructure in preparation for future growth, a $0.1 million and $0.5 million increase in subscription fees to third-party SaaS providers due primarily to upgrading subscriptions to existing software and adding subscriptions to new software to support our growth, and a $0.2 million and a $0.2 million increase in facility and office-related costs due to expanded office space, respectively. These increases for the three and nine months ended September 30, 2014 compared to the same periods of 2013 were offset in part by a $0.5 million and a $3.2 million decrease, respectively, in contingent state and local taxes and surcharges on usage-based fees because we commenced collecting state and local taxes and surcharges from our clients for applicable states in June 2014 and we recorded a $2.8 million credit in the second quarter of 2014 as a result of a favorable ruling from a specific state's revenue authority (see Note 10 of the notes to our condensed consolidated financial statements).

Excluding the credit of $2.8 million recorded in the second quarter of 2014 and the charge of $2.0 million for the potential FCC settlement recorded in the third quarter of 2014, general and administrative expenses as a percentage of revenue increased to 23% and 25% during the three and nine months ended September 30, 2014 from 20% and 20% for the same periods of 2013, primarily as a result of increased headcount to support our growth and operate as a public company.

Other Income (Expense), Net

	Three Months Ended				Nine Months Ended			
	September 30, 2014	September 30, 2013	$ Change	% Change	September 30, 2014	September 30, 2013	$ Change	% Change
	(in thousands, except percentages)							
Change in fair value of convertible preferred and common stock warrant liabilities	$—	$ (622)	$622	(100)%	$1,745	$ (1,177)	$2,922	(248)%
Interest expense	(1,116)	(273)	(843)	309%	(2,986)	(666)	(2,320)	348%
Interest income and other	95	(15)	110	(733)%				