ServiceNow, Inc.
Form 10-Q
November 04, 2015

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

FORM 10-Q

x Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2015
OR
¨ Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Commission File Number: 001-35580

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

Delaware	20-2056195
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

ServiceNow, Inc.
3260 Jay Street
Santa Clara, California 95054
(408) 501-8550
(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 ¨

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 ¨

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 the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

As of October 31, 2015, there were approximately 159.0 million shares of the Registrant’s Common Stock outstanding.

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PART I

ITEM 1. FINANCIAL STATEMENTS

SERVICENOW, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)

	September 30, 2015 (Unaudited)	December 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	$349,073	$252,455
Short-term investments	379,878	416,336
Accounts receivable, net	159,768	159,171
Current portion of deferred commissions	47,583	43,232
Prepaid expenses and other current assets	45,305	35,792
Total current assets	981,607	906,986
Deferred commissions, less current portion	29,595	29,453
Long-term investments	400,512	266,772
Property and equipment, net	132,713	104,237
Intangible assets, net	44,527	54,526
Goodwill	55,547	55,016
Other assets	18,387	8,089
Total assets	$1,662,888	$1,425,079
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$30,654	$17,829
Accrued expenses and other current liabilities	84,681	79,497
Current portion of deferred revenue	519,486	409,671
Total current liabilities	634,821	506,997
Deferred revenue, less current portion	8,917	12,567
Convertible senior notes, net	466,831	443,764
Other long-term liabilities	35,385	33,076
Total liabilities	1,145,954	996,404
Stockholders' equity:		
Common stock	157	150
Additional paid-in capital	1,051,480	799,221
Accumulated other comprehensive loss	(15,072)	(12,113)
Accumulated deficit	(519,631)	(358,583)
Total stockholders' equity	516,934	428,675
Total liabilities and stockholders' equity	$1,662,888	$1,425,079

See accompanying notes to condensed consolidated financial statements

SERVICENOW, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(Unaudited)
(in thousands, except share and per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Revenues:				
Subscription	$223,208	$150,367	$603,576	$400,466
Professional services and other	37,942	28,345	116,254	84,093
Total revenues	261,150	178,712	719,830	484,559
Cost of revenues(1):				
Subscription	46,053	37,925	133,889	102,357
Professional services and other	35,835	28,161	104,615	75,781
Total cost of revenues	81,888	66,086	238,504	178,138
Gross profit	179,262	112,626	481,326	306,421
Operating expenses(1):				
Sales and marketing	117,899	84,002	364,530	245,355
Research and development	55,822	39,683	158,946	106,232
General and administrative	33,581	23,440	93,357	69,985
Total operating expenses	207,302	147,125	616,833	421,572
Loss from operations	(28,040)	(34,499)	(135,507)	(115,151)
Interest and other expense, net	(11,791)	(5,949)	(21,851)	(17,143)
Loss before provision for income taxes	(39,831)	(40,448)	(157,358)	(132,294)
Provision for income taxes	1,199	602	3,690	2,430
Net loss	$(41,030)	$(41,050)	$(161,048)	$(134,724)
Net loss per share - basic and diluted	$(0.26)	$(0.28)	$(1.04)	$(0.93)
Weighted-average shares used to compute net loss per share - basic and diluted	156,930,506	146,335,519	154,352,037	144,239,844
Other comprehensive loss:				
Foreign currency translation adjustments	$(2,689)	$(6,710)	$(3,028)	$(6,024)
Unrealized gain (loss) on investments	(173)	(212)	108	178
Tax provision (benefit)	(62)	—	39	—
Other comprehensive loss, net of tax	(2,800)	(6,922)	(2,959)	(5,846)
Comprehensive loss	$(43,830)	$(47,972)	$(164,007)	$(140,570)

(1) Includes stock-based compensation as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Cost of revenues:				
Subscription	$5,951	$3,995	$17,183	$10,896
Professional services and other	5,804	3,572	16,788	9,188
Sales and marketing	26,011	14,956	74,690	36,382
Research and development	18,130	11,682	51,703	29,973
General and administrative	9,215	7,285	29,167	21,884

See accompanying notes to condensed consolidated financial statements

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

	Nine Months Ended September 30,	
	2015	2014
Cash flows from operating activities:		
Net loss	$(161,048)	$(134,724)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	43,957	28,734
Amortization of premiums on investments	5,380	6,044
Amortization of deferred commissions	48,055	36,398
Amortization of debt discount and issuance costs	23,124	21,608
Stock-based compensation	189,531	108,323
Tax benefit from exercise of stock options	(1,181)	(1,190)
Other	(5,393)	(1,973)
Changes in operating assets and liabilities:		
Accounts receivable	(5,303)	(6,935)
Deferred commissions	(54,168)	(47,115)
Prepaid expenses and other assets	(8,915)	(2,386)
Accounts payable	8,312	3,892
Deferred revenue	115,812	92,351
Accrued expenses and other liabilities	11,856	(11,751)
Net cash provided by operating activities	210,019	91,276
Cash flows from investing activities:		
Purchases of property and equipment	(62,588)	(45,499)
Acquisition, net of cash acquired	(1,100)	(99,813)
Purchases of investments	(543,167)	(360,783)
Purchase of strategic investment	(10,000)	—
Sale of investments	242,631	97,807
Maturities of investments	203,632	134,618
Restricted cash	(408)	(55)
Net cash used in investing activities	(171,000)	(273,725)
Cash flows from financing activities:		
Proceeds from employee stock plans	73,347	54,398
Taxes paid related to net share settlement of equity awards	(12,603)	(494)
Tax benefit from exercise of stock options	1,181	1,190
Payments on financing obligation	(112)	—
Net cash provided by financing activities	61,813	55,094
Foreign currency effect on cash and cash equivalents	(4,214)	(3,862)
Net increase (decrease) in cash and cash equivalents	96,618	(131,217)
Cash and cash equivalents at beginning of period	252,455	366,303
Cash and cash equivalents at end of period	$349,073	$235,086
Supplemental disclosures of non-cash investing activities:		
Property and equipment included in accounts payable and accrued expenses	$14,381	$6,220

See accompanying notes to condensed consolidated financial statements

SERVICENOW, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Unless the context requires otherwise, references in this report to “ServiceNow,” the "Company", “we,” “us,” and “our” refer to ServiceNow, Inc. and its consolidated subsidiaries.

(1) Description of the Business

ServiceNow is a leading provider of cloud-based solutions that define, structure, manage and automate services across the global enterprise. By applying a service-oriented lens to the activities, tasks and processes that comprise day-to-day work life, we help the modern enterprise operate faster and be more scalable than ever before.

(2) Summary of Significant Accounting Policies

Basis of Presentation
The accompanying unaudited condensed consolidated financial statements and condensed footnotes have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring items) considered necessary for fair statement of results for the interim periods presented have been included. The results of operations for the three and nine months ended September 30, 2015 are not necessarily indicative of the results to be expected for the year ended December 31, 2015 or for other interim periods or for future years. The condensed consolidated balance sheet as of December 31, 2014 is derived from audited financial statements as of that date, however, it does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in the Company’s Form 10-K for the year ended December 31, 2014, which was filed with the Securities and Exchange Commission on February 27, 2015.

Principles of Consolidation

The condensed consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles, or GAAP, and include our accounts and the accounts of our wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated upon consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires management to make certain estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements, as well as reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Warranties and Indemnification

Our cloud-based service to automate services across the global enterprise is typically warranted to perform in material conformance with its specifications.

We include service-level commitments to our customers that permit those customers to receive credits in the event we fail to meet those service levels. We establish an accrual based on historical credits paid and an evaluation of the performance of our services including an assessment of the impact, if any, of any known service disruptions. Service-level credit accrual charges are recorded against revenue. The service-level credit accrual was not material as of September 30, 2015 and December 31, 2014.

We have also agreed to indemnify our directors and executive officers for costs associated with any fees, expenses, judgments, fines and settlement amounts incurred by any of these persons in any action or proceeding to which any of those persons is, or is threatened to be, made a party by reason of the person's service as a director or officer, including any action by us, arising out of that person's services as a director or officer of our company or that person's services provided to any other company or enterprise at our request. We maintain director and officer insurance coverage that may enable us to recover a portion of any future amounts paid. The fair values of these obligations are not material as of each balance sheet date.

Our agreements include provisions indemnifying customers against intellectual property and other third-party claims. We have not incurred any costs as a result of such indemnification obligations and have not recorded any liabilities related to such obligations in the consolidated financial statements.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board, or FASB, issued an update to ASC 606 Revenue from Contracts with Customers, or ASC 606, that will supersede virtually all existing revenue guidance. Under this update, an entity is required to recognize revenue upon transfer of promised goods or services to customers in an amount that reflects the expected consideration received in exchange for those goods or services. As such, an entity will need to use more judgment and make more estimates than under the current guidance. This update should be applied retrospectively either to each prior reporting period presented in the financial statements, or only to the most current reporting period presented in the financial statements with a cumulative effect adjustment recorded in the retained earnings. This update is effective for our interim and annual reporting periods beginning January 1, 2018. Early adoption is permitted for us on January 1, 2017. We are currently evaluating the impact of this update on our consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03, Simplifying the Presentation of Debt Issuance Costs. To simplify presentation of debt issuance costs, this new guidance requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. This guidance will become effective for financial statements issued for fiscal years beginning after December 15, 2015 and interim periods within those fiscal years. Early adoption is permitted. This ASU is not expected to have a material impact on our consolidated financial statements or disclosures.

(3) Investments

Marketable securities

The following is a summary of our available-for-sale investment securities, excluding those securities classified within cash and cash equivalents on the consolidated balance sheets (in thousands):

	September 30, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale securities:				
Commercial paper	$11,356	$9	$—	$11,365
Corporate notes and bonds	618,988	85	(990)	618,083
Certificates of deposit	41,055	21	(3)	41,073
U.S. government agency securities	109,735	134	—	109,869
Total available-for-sale securities	$781,134	$249	$(993)	$780,390

	December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale securities:				
Commercial paper	$8,195	$1	$—	$8,196
Corporate notes and bonds	554,421	56	(845)	553,632

Certificates of deposit	27,251	8	(2)	27,257
U.S. government agency securities	94,093	2	(72)	94,023
Total available-for-sale securities	$683,960	$67	$(919)	$683,108

As of September 30, 2015, the contractual maturities of our investments did not exceed 24 months. The fair values of available-for-sale investments, by remaining contractual maturity, are as follows (in thousands):

	September 30, 2015
Due in 1 year or less	$379,878
Due in 1 year through 2 years	400,512
Total	$780,390

We had certain available-for-sale securities in a gross unrealized loss position, substantially all of which had been in such position for less than 12 months. There were no impairments considered "other-than-temporary" as it is more likely than not we will hold the securities until maturity or a recovery of the cost basis. The following table shows the fair values and the gross unrealized losses of these available-for-sale securities aggregated by investment types (in thousands):

	September 30, 2015		December 31, 2014	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Corporate notes and bonds	$401,772	$(990)	$436,140	$(845)
Certificates of deposit	11,802	(3)	7,999	(2)
U.S. government agency securities	—	—	80,014	(72)
Total	$413,574	$(993)	$524,153	$(919)

Strategic investment

During the nine months ended September 30, 2015, we purchased a non-marketable equity investment in a privately-held company. This investment is accounted for under the cost method as we have less than a 20% ownership interest and we do not have the ability to exercise significant influence over the operations of the company. The carrying value of our investment was $10.0 million as of September 30, 2015, which is included in "Other assets" on the condensed consolidated balance sheets. We monitor this non-marketable equity investment for impairment and will make an appropriate reduction in carrying value if we determine that an impairment charge is required based primarily on the financial condition and near-term prospects of the privately-held company.

(4) Fair Value Measurements

The following table presents our fair value hierarchy for our assets measured at fair value on a recurring basis at September 30, 2015 (in thousands):

	Level 1	Level 2	Total
Cash equivalents:			
Money market funds	$160,582	$—	$160,582
Short-term investments:			
Commercial paper	—	11,365	11,365
Corporate notes and bonds	—	312,176	312,176
Certificates of deposit	—	33,913	33,913
U.S. government agency securities	—	22,424	22,424
Long-term investments:			
Corporate notes and bonds	—	305,907	305,907
Certificates of deposit	—	7,160	7,160
U.S. government agency securities	—	87,445	87,445

Total	$160,582	$780,390	$940,972

The following table presents our fair value hierarchy for our assets measured at fair value on a recurring basis at December 31, 2014 (in thousands):

	Level 1	Level 2	Total
Cash equivalents:			
Money market funds	$46,541	$—	$46,541
Commercial paper	—	4,600	4,600
Short-term investments:			
Commercial paper	—	8,196	8,196
Corporate notes and bonds	—	342,864	342,864
Certificates of deposit	—	25,258	25,258
U.S. government agency securities	—	40,018	40,018
Long-term investments:			
Corporate notes and bonds	—	210,768	210,768
Certificates of deposit	—	1,999	1,999
U.S. government agency securities	—	54,005	54,005
Total	$46,541	$687,708	$734,249

We determine the fair value of our security holdings based on pricing from our service provider and market prices from industry-standard independent data providers. Such market prices may be quoted prices in active markets for identical assets (Level 1 inputs) or pricing determined using inputs other than quoted prices that are observable either directly or indirectly (Level 2 inputs), such as yield curve, volatility factors, credit spreads, default rates, loss severity, current market and contractual prices for the underlying instruments or debt, broker and dealer quotes, as well as other relevant economic measures.

(5) Goodwill and Intangible Assets

Goodwill balances are presented below (in thousands):

	Carrying Amount
Balance as of December 31, 2014	$55,016
Goodwill acquired	1,442
Foreign currency translation adjustments	(911)
Balance as of September 30, 2015	$55,547

On February 27, 2015, we completed the acquisition of Intreis, Inc., a professional services company with domain expertise in enterprise governance, risk and compliance solutions. Of the $1.6 million in total purchase consideration, $0.2 million is allocated to net tangible assets and $1.4 million is allocated to goodwill, which represents the synergies expected from the workforce integration. The goodwill balance is deductible for U.S. income tax purposes. $0.5 million of the total purchase consideration will be paid one year following the close of the acquisition. The results of operations of Intreis have been included in our condensed consolidated financial statements from the date of purchase. This business combination did not have a material impact on our consolidated financial statements, and therefore pro forma disclosures have not been presented.

Intangible assets consist of the following (in thousands):

	September 30, 2015		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	$58,605	$(14,846)	$43,759
Backlog	587	(478)	109
Other acquisition-related intangible assets	568	(515)	53
Acquisition-related intangible assets	59,760	(15,839)	43,921
Other intangible assets	1,075	(469)	606
Total intangible assets	$60,835	$(16,308)	$44,527

	December 31, 2014		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	$59,895	$(6,727)	$53,168
Backlog	588	(184)	404
Other acquisition-related intangible assets	597	(398)	199
Acquisition-related intangible assets	61,080	(7,309)	53,771
Other intangible assets	1,075	(320)	755
Total intangible assets	$62,155	$(7,629)	$54,526

Amortization expense for intangible assets for the three months ended September 30, 2015 and 2014 was approximately $2.9 million and $2.8 million, respectively, and for the nine months ended September 30, 2015 and 2014 was approximately $8.8 million and $3.7 million, respectively.

(6) Property and Equipment

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

	September 30, 2015	December 31, 2014
Computer equipment and software	$162,672	$128,546
Furniture and fixtures	20,447	18,253
Leasehold improvements	17,133	14,929
Building	6,274	—
Construction in progress	16,315	9,762
	222,841	171,490
Less: Accumulated depreciation	(90,128)	(67,253)
Total property and equipment, net	$132,713	$104,237

During the year ended December 31, 2014, we entered into a new lease for office space in Tel Aviv, Israel. We concluded for accounting purposes, that we were considered the owner of the building during the construction period as we were responsible to fund the construction costs related to structural improvements necessary to make the space ready for use. Following completion of construction during the three months ended March 31, 2015, we concluded we retained continuing involvement to preclude de-recognition of the building. As such, we continue to account for the building as owned real estate and record a financing obligation for our obligation to the legal owner. The building will be reflected as an asset on our condensed consolidated balance sheet through May 31, 2025, the period of intended use, and depreciated on a straight-line basis over a period of approximately 39 years. Rent payments made under this lease will be recorded as interest expense and principal reduction to the financing obligation.

Construction in progress consists primarily of leasehold improvements and in-process software development costs. Depreciation expense for the three months ended September 30, 2015 and 2014 was $12.2 million and $9.3 million, respectively, and for the nine months ended September 30, 2015 and 2014 was $35.1 million and $25.0 million, respectively.

(7) Accrued Expenses and Other Current Liabilities

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

	September 30, 2015	December 31, 2014
Taxes payable	$7,326	$7,625
Bonuses and commissions	28,099	28,228
Accrued compensation	15,809	14,961
Other employee expenses	13,930	16,080
Other	19,517	12,603
Total accrued expenses and other current liabilities	$84,681	$79,497

(8) Convertible Senior Notes

In November 2013, we issued 0% convertible senior notes due November 1, 2018 with an aggregate principal amount of $575 million, or the Notes. The Notes will not bear interest. The Notes mature on November 1, 2018 unless converted or repurchased in accordance with their terms prior to such date. We cannot redeem the Notes prior to maturity.

The Notes are unsecured obligations and do not contain any financial covenants or restrictions on the payments of dividends, the incurrence of indebtedness or the issuance or repurchase of securities by us or any of our subsidiaries. Upon conversion, we may choose to pay or deliver, as the case may be, cash, shares of our common stock or a combination of cash and shares of our common stock. We intend to settle the principal amount of the Notes with cash.

The Notes are convertible up to 7.8 million shares of our common stock at an initial conversion rate of approximately 13.54 shares of common stock per $1,000 principal amount, which is equal to an initial conversion price of approximately $73.88 per share of common stock, subject to adjustment. Holders of the Notes may convert their Notes at their option at any time prior to the close of business on the business day immediately preceding July 1, 2018, only under the following circumstances:

- during any calendar quarter commencing after the calendar quarter ending on March 31, 2014 (and only during such calendar quarter), if the last reported sale price of the common stock for at least 20 trading days (whether or not consecutive) during the period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day;

- during the five business day period after any five consecutive trading day period, or the measurement period, in which the trading price per $1,000 principal amount of the Notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of our common stock and the conversion rate on each such trading day; or

- upon the occurrence of specified corporate events.

On or after July 1, 2018, a holder may convert all or any portion of its notes at any time prior to the close of business on the second scheduled trading day immediately preceding the maturity date regardless of the foregoing conditions. Upon conversion, we will pay or deliver, as the case may be, cash, shares of our common stock or a combination of cash and shares of our common stock, at our election.

The conversion price will be subject to adjustment in some events. Holders of the Notes who convert their notes in connection with certain corporate events that constitute a “make-whole fundamental change” are, under certain circumstances, entitled to an increase in the conversion rate. Additionally, in the event of a corporate event that constitutes a “fundamental change,” holders of the Notes may require us to purchase with cash all or a portion of the Notes upon the occurrence of a fundamental change, at a purchase price equal to 100% of the principal amount of the Notes plus any accrued and unpaid interest.

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In accounting for the issuance of the Notes, we separated the Notes into liability and equity components. The carrying cost of the liability component was calculated by measuring the fair value of a similar liability that does not have an associated convertible feature. The carrying amount of the equity component representing the conversion option was determined by deducting the fair value of the liability component from the par value of the Notes. The difference between the principal amount of the Notes and the proceeds allocated to the liability component, or the debt discount, is amortized to interest expense using the effective interest method over the term of the Note. The equity component is not remeasured as long as it continues to meet the conditions for equity classification.

In accounting for the transaction costs related to the issuance of the Notes, we allocated the total amount incurred to the liability and equity components based on their relative fair values. Transaction costs attributable to the liability component are being amortized to interest expense over the term of the Notes, and transaction costs attributable to the equity component were netted with the equity component of the Notes in stockholders' equity. The Notes consisted of the following (in thousands):

	September 30, 2015	December 31, 2014
Liability:		
Principal	$575,000	$575,000
Less: debt discount, net of amortization	(108,169)	(131,236)
Net carrying amount	$466,831	$443,764

We consider the fair value of the Notes at September 30, 2015 and December 31, 2014 to be a Level 2 measurement. The estimated fair values of the Notes were $650.6 million and $653.3 million at September 30, 2015 and December 31, 2014, respectively. The fair value was determined based on the closing trading price per $100 of the Notes on September 30, 2015. The Notes were not convertible as of September 30, 2015 and December 31, 2014.

As of September 30, 2015, the remaining life of the Notes is 37 months. The following table sets forth total interest expense recognized related to the Notes (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Amortization of debt issuance cost	$420	$393	$1,240	$1,158
Amortization of debt discount	7,419	6,932	21,884	20,450
Total	$7,839	$7,325	$23,124	$21,608
Effective interest rate of the liability component	6.5%			

Note Hedge

To minimize the impact of potential economic dilution upon conversion of the Notes, we entered into convertible note hedge transactions, or the Note Hedge, with respect to our common stock concurrent with the issuance of the Notes. The Note Hedge covers approximately 7.8 million shares of our common stock at a strike price per share that corresponds to the initial conversion price of the Notes, subject to adjustment, and is exercisable upon conversion of the Notes. We paid an aggregate amount of $135.8 million for the Note Hedge. The Note Hedge will expire upon maturity of the Notes. The Note Hedge is intended to reduce the potential economic dilution upon conversion of the Notes in the event that the fair value per share of our common stock at the time of exercise is greater than the conversion price of the Notes. The Note Hedge is a separate transaction and is not part of the terms of the Notes. The Note Hedge does not impact earnings per share, as it was entered into to offset any dilution from the Notes.

Warrants

Separately, we entered into warrant transactions, or the Warrants, whereby we sold warrants to acquire up to 7.8 million shares of our common stock, at a strike price of $107.46 per share, subject to adjustment. We received aggregate proceeds of $84.5 million from the sale of the Warrants. If the average market value per share of our common stock for the reporting period, as measured under the Warrants, exceeds the strike price of the Warrants, the Warrants will have a dilutive effect on our earnings per share. The Warrants are separate transactions and are not remeasured through earnings each reporting period. The Warrants are not part of the Notes or the Note Hedge, and have been accounted for as part of additional paid-in capital.

(9) Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss, net of tax, consist of the following (in thousands):

	September 30, 2015	December 31, 2014
Foreign currency translation adjustment	$(14,289)	$(11,261)
Net unrealized loss on investments	(783)	(852)
Accumulated other comprehensive loss	$(15,072)	$(12,113)

Reclassification adjustments out of accumulated other comprehensive loss into net loss were immaterial for all periods presented.

(10) Stockholders' Equity

Common Stock

We were authorized to issue 600,000,000 shares of common stock as of September 30, 2015. Holders of our common stock are not entitled to receive dividends unless declared by our board of directors. As of September 30, 2015, we had 158,095,325 shares of common stock outstanding and had reserved shares of common stock for future issuance as follows:

	September 30, 2015
Stock option plans:	
Options outstanding	10,235,318
RSUs	12,716,479
Stock awards available for future grants:	
2012 Equity Incentive Plan[1]	16,683,799
2012 Employee Stock Purchase Plan[1]	7,561,621
Total reserved shares of common stock for future issuance	47,197,217

(1) Refer to Note 11 for a description of these plans.

During the nine months ended September 30, 2015 and 2014, we issued a total of 8,586,233 shares and 7,078,520 shares, respectively, from stock option exercises, vesting of restricted stock units, or RSUs, and purchases from the employee stock purchase plan, or ESPP.

(11) Stock Awards

We have a 2005 Stock Option Plan, or 2005 Plan, which provides for grants of stock awards, including options to purchase shares of common stock, stock purchase rights and RSUs to certain employees, officers, directors and consultants.

Our 2012 Equity Incentive Plan, or 2012 Plan, provides for the grant of incentive stock options, nonqualified stock options, stock appreciation rights, RSUs, performance-based stock awards and other forms of equity compensation, or collectively, stock awards. In addition, the 2012 Plan provides for the grant of performance cash awards. Incentive stock options may be granted only to employees. All other awards may be granted to employees, including officers, as well as directors and consultants. The share reserve may increase to the extent outstanding stock options under the 2005 Plan expire or terminate unexercised. The share reserve also automatically increases on January 1 of each year until January 1, 2022, by up to 5% of the total number of shares of common stock outstanding on December 31 of the preceding year as determined by the board of directors. On January 1, 2015, 7,475,454 shares of common stock were automatically added to the 2012 Plan pursuant to the provision described in the preceding sentence.

Our 2012 Employee Stock Purchase Plan, or 2012 ESPP, authorizes the issuance of shares of common stock pursuant to purchase rights granted to our employees. The number of shares of common stock reserved for issuance automatically increases on January 1 of each year until January 1, 2022, by up to 1% of the total number of shares of common stock outstanding on December 31 of the preceding year as determined by the board of directors. The price at which common stock is purchased under the 2012 ESPP is equal to 85% of the fair market value of the common stock on the first or last day of the offering period, whichever is lower. Offering periods are six months long and begin on February 1 and August 1 of each year. On January 1, 2015, 1,495,090 shares of common stock were automatically added to the 2012 ESPP pursuant to the provision described in the preceding sentence.

Stock Options

A summary of the stock option activity for the nine months ended September 30, 2015 is as follows:

	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2014	15,897,422	$11.96		
Granted	251,048	75.00		
Exercised	(5,718,791)	8.51		$381,313
Canceled	(194,361)	21.36		
Outstanding at September 30, 2015	10,235,318	$15.25	6.32	$556,150
Vested and expected to vest as of September 30, 2015	10,086,362	$14.68	6.29	$553,645
Vested and exercisable as of September 30, 2015	8,043,491	$8.52	5.93	$490,060

Aggregate intrinsic value represents the difference between the estimated fair value of our common stock and the exercise price of outstanding, in-the-money options. The weighted-average grant date fair value per share of options granted was $32.90 for the nine months ended September 30, 2015. The total fair value of shares vested was $28.2 million for the nine months ended September 30, 2015.

As of September 30, 2015, total unrecognized compensation cost, adjusted for estimated forfeitures, related to unvested stock options was approximately $35.9 million. The weighted-average remaining vesting period of unvested stock options at September 30, 2015 was 2.24 years.

RSUs

A summary of RSU activity for the nine months ended September 30, 2015 is as follows:

	Number of Shares	Weighted Average Grant Date Fair Value (Per Share)	Aggregate Fair Value (in thousands)
Non-vested and outstanding at December 31, 2014	9,941,074	$51.19	
Granted	6,260,298	73.04	
Vested	(2,574,530)	47.75	$193,700
Forfeited	(910,363)	59.10	
Non-vested and outstanding at September 30, 2015	12,716,479	$62.08	$883,159
Expected to vest as of September 30, 2015	10,647,480		$739,467

RSUs granted under the 2005 Plan and the 2012 Plan to employees generally vest annually over a four-year period. As of September 30, 2015, total unrecognized compensation cost, adjusted for estimated forfeitures, related to unvested RSUs was approximately $543.9 million and the weighted-average remaining vesting period was 3.01 years.

(12) Interest and other expense, net

The components of interest and other expense, net, consist of the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Interest expense related to the Notes	$(7,839)	$(7,325)	$(23,124)	$(21,608)
Interest income	1,252	730	3,274	2,132
Foreign currency exchange gain/(loss)	(5,063)	655	(1,771)	2,336
Other	(141)	(9)	(230)	(3)
Interest and other expense, net	$(11,791)	$(5,949)	$(21,851)	$(17,143)

(13) Net Loss Per Share

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Numerator:				
Net loss	$(41,030)	$(41,050)	$(161,048)	$(134,724)
Denominator:				
Weighted-average shares outstanding—basic and diluted	156,930,506	146,335,519	154,352,037	144,239,844
Net loss per share:				
Basic	$(0.26)	$(0.28)	$(1.04)	$(0.93)
Diluted	$(0.26)	$(0.28)	$(1.04)	$(0.93)

Potentially dilutive securities that are not included in the calculation of diluted net loss per share because doing so would be antidilutive are as follows:

	September 30,	
	2015	2014
Common stock options	10,235,318	17,824,088
Restricted stock units	12,716,479	9,410,497
Common stock subject to repurchase	—	29,712
ESPP obligations	270,426	280,355
Convertible senior notes	7,783,023	7,783,023
Warrants related to the issuance of convertible senior notes	7,783,023	7,783,023
Total potentially dilutive securities	38,788,269	43,110,698

(14) Income Taxes

We compute our provision for income taxes by applying the estimated annual effective tax rate to year-to-date loss from recurring operations and adjust the provision for discrete tax items recorded in the period.

Our effective tax rate for the three and nine months ended September 30, 2015 was (3)% and (2)%, respectively, which was lower than the U.S. federal statutory tax rate of 34%. The lower tax rate was primarily attributable to our loss from operations, the foreign tax rate differential, non-deductible expenses arising from stock-based compensation and the tax effects of unrealized gains in investment securities.

Our effective tax rate for the three and nine months ended September 30, 2014 was (1)% and (2)%, respectively, which was lower than the federal statutory tax rate of 34%. The lower tax rate was primarily attributable to our loss from operations, the foreign tax rate differential, and non-deductible expenses arising from stock-based compensation.

We are subject to taxation in the United States and foreign jurisdictions. As of September 30, 2015, our tax years 2005 to 2014 remain subject to examination in most jurisdictions. We are currently appealing the results of the examination by the U.S. Internal Revenue Service for the June 30, 2011 and December 31, 2011 tax years.

There are differing interpretations of tax laws and regulations, and as a result, disputes may arise with tax authorities involving issues of the timing and amount of deductions and allocations of income among various tax jurisdictions. We periodically evaluate our exposures associated with our tax filing positions. We believe that adequate amounts have been reserved for any adjustments that may ultimately result from these examinations, and we do not anticipate a significant impact to our gross unrecognized tax benefits within the next 12 months related to these years. Although the timing of the resolution, settlement, and closure of any audit is highly uncertain, it is reasonably possible that the balance of gross unrecognized tax benefits could significantly change in the next 12 months. However, given the number of years that remain subject to examination, we are unable to estimate the full range of possible adjustments to the balance of gross unrecognized tax benefits.

(15) Commitments and Contingencies

Leases

We lease facilities for data center capacity and office space under non-cancelable operating lease agreements with various expiration dates. There have been no material changes in our commitments under contractual obligations, as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2014.

Legal Proceedings

From time to time, we are party to litigation and other legal proceedings in the ordinary course of business. While the results of any litigation or other legal proceedings are uncertain, management does not believe the ultimate resolution of any pending legal matters is likely to have a material adverse effect on our financial position, results of operations or cash flows, except as discussed below and for those matters for which we have recorded a loss contingency. We accrue for loss contingencies when it is both probable that we will incur the loss and when we can reasonably estimate the amount of the loss or range of loss.

Generally, our subscription agreements require us to defend our customers for third-party intellectual property infringement and other claims. Any adverse determination related to intellectual property claims or other litigation could prevent us from offering our services and adversely affect our financial condition and results of operations.

On February 6, 2014, Hewlett-Packard Company filed a lawsuit against us in the U.S. District Court for the Northern District of California that alleges that some of our services infringe the claims of eight Hewlett-Packard patents. Hewlett-Packard is seeking unspecified damages and an injunction. We filed an answer to the complaint on March 28, 2014 denying the allegations and asserting various affirmative defenses. The parties are currently conducting discovery. Hewlett-Packard served infringement contentions on July 3, 2014 and November 18, 2014. We served invalidity contentions on January 9, 2015. On March 10, 2015, the court granted our motion for summary judgment, finding that the asserted claims of four of the eight asserted Hewlett-Packard patents are invalid for failing to claim patentable subject matter. The United States Patent and Trademark Office has instituted inter partes review of four of the asserted patents. On October 13, 2015, the court granted in part our renewed motion for a stay of litigation, staying all proceedings as to two of the four remaining asserted patents pending final decisions from the United States Patent and Trademark Office on our petitions for inter partes review. A claim construction hearing for the two asserted patents not subject to the court's stay is scheduled for December 18, 2015. The trial is currently scheduled to begin on May 22, 2017.

On September 23, 2014, BMC Software, Inc. filed a lawsuit against us in the U.S. District Court for the Eastern District of Texas that alleges that some of our services willfully infringe the claims of seven BMC patents. BMC is seeking unspecified damages and an injunction. BMC served infringement contentions on January 6, 2015. We served invalidity contentions on March 3, 2015. We filed an answer to the complaint on June 1, 2015 denying the allegations and asserting various affirmative defenses. A claim construction hearing occurred on July 10, 2015, followed by the court's claim construction order on August 13, 2015. The parties are currently conducting expert discovery. The trial is currently scheduled to begin on March 14, 2016. We have filed petitions for inter partes review of six of the asserted patents, challenging the validity of the patents with the United States Patent and Trademark Office.

We intend to vigorously defend these lawsuits. These litigation matters are still in their early stages and the final outcome, including our liability, if any, with respect to the claims in the lawsuits, is uncertain. If an unfavorable outcome were to occur in either litigation, the impact could be material to our business, financial condition, cash flow or results of operations, depending on the specific circumstances of the outcome. We cannot make a reasonable estimate of the potential loss or range of loss, if any, arising from these matters.

(16) Information about Geographic Areas

Revenues by geographic area, based on the location of our users, were as follows for the periods presented (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Revenues by geography:				
North America [1]	$181,293	$120,435	$504,326	$329,660
EMEA [2]	61,663	46,521	165,996	125,021
Asia Pacific and other	18,194	11,756	49,508	29,878
Total revenues	$261,150	$178,712	$719,830	$484,559

Long-lived assets by geographic area were as follows (in thousands):

	September 30, 2015	December 31, 2014
Long-lived assets:		
North America[3]	$94,003	$66,489
EMEA[2]	29,725	27,032
Asia Pacific and other	8,985	10,716
Total long-lived assets	$132,713	$104,237

(1) Revenues attributed to the United States were approximately 95% of North America revenues for the three and nine months ended September 30, 2015, and 94% for the three months and nine months ended September 30, 2014.
(2) Europe, the Middle East and Africa
(3) Long-lived assets attributed to the United States were approximately 99% and 97% of North America long-lived assets as of September 30, 2015 and December 31, 2014, respectively.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition, results of operations and cash flows should be read in conjunction with the (1) unaudited condensed consolidated financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q, and (2) the audited consolidated financial statements and notes thereto and management's discussion and analysis of financial condition and results of operations for the year ended December 31, 2014 included in the Form 10-K dated as of, and filed with the Securities and Exchange Commission, or the SEC, on February 27, 2015 (File No. 001-35580). This Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. These statements are often identified by the use of words such as "may," "will," "expect," "believe," "anticipate," "intend," "could," "estimate," or "continue," and similar expressions or variations. Such forward-looking statemen are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified herein, and those discussed in the section titled "Risk Factors", set forth in Part II, Item 1A of this Quarterly Report on Form 10-Q and in our other SEC filings. We disclaim any obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

Certain measures in the section entitled "—Key Factors Affecting Our Performance—Billings," "—Comparison of the Three Months Ended September 30, 2015 and 2014" and "—Comparison of the Nine Months Ended September 30, 2015 and 2014" are presented on a constant currency basis. These measures are not in accordance with U.S. Generally Accepted Accounting Principles, or GAAP. These non-GAAP financial measures are not intended to be considered in isolation or as a substitute for, or superior to, financial information prepared and presented in accordance with GAAP. These measures may be different from non-GAAP financial measures used by other companies, limiting their usefulness for comparison purposes. We believe investors should consider these non-GAAP financial measures in evaluating our results as they are indicative of our ongoing performance and reflect how management evaluates our operational results and trends.

Overview

ServiceNow is a leading provider of cloud-based solutions that define, structure, manage and automate services across the global enterprise. By applying a service-oriented lens to the activities, tasks and processes that comprise day-to-day work life, we help the modern enterprise operate faster and be more scalable than ever before. We offer our services on an annual subscription fee basis which includes access to the ordered subscription service and related support including updates to the subscribed service during the subscription term. We provide a scaled pricing model based on the duration of the subscription term and we frequently extend discounts to our customers based on the number of users. We generate sales through our direct sales team and indirectly through channel partners and third-party referrals. We also generate revenues from professional services for implementation and training of customer personnel. We generally bill our customers annually in advance for subscription services and monthly in arrears for our professional services as the work is performed.

A majority of our revenues come from large global enterprise customers. We continue to invest in the development of our services, infrastructure and sales and marketing to drive long-term growth. We increased our overall employee headcount to 3,402 as of September 30, 2015 from 2,611 as of September 30, 2014.

Key Factors Affecting Our Performance

Renewal rate. We calculate our renewal rate by subtracting our attrition rate from 100%. Our attrition rate for a period is equal to the annualized contract value, or ACV, from lost customers, divided by the total ACV from all customers that renewed during the period, excluding any price changes or upsells, and total ACV from all lost customers. A lost customer is a customer that did not renew a contract expiring in the period and that, in our judgment, will not renew. Typically a customer that reduces its subscription upon renewal is not considered a lost customer. However, in instances where the subscription decrease represents the majority of the customer's ACV, we may deem the renewal as a lost customer. Our renewal rate was 98% and 97% for the three and nine months ended September 30, 2015, respectively, and 98% for the three and nine months ended September 30, 2014.

Upsell rate. To grow our business it is important for us to generate additional sales from existing customers, which we refer to as our upsell rate. We calculate our upsell rate as the ACV of upsells, net of losses and reductions in ACV from existing customers during the period, divided by our total ACV signed during the period. The upsell rate was 37% and 43% for the three months ended September 30, 2015 and 2014, respectively, and 38% and 43% for the nine months ended September 30, 2015 and 2014, respectively. The decrease in upsell rate for the nine months ended September 30, 2015 compared to the same period in the prior year is primarily due to the increase in total signed ACV resulting from higher renewal ACV during the nine months ended September 30, 2015. We expect our upsell rate to decrease in the long term as our renewal base continues to grow.

Our upsells are primarily derived from an increase in the number of user accounts purchased by our customers and are also derived from the addition of other subscription services. In the first quarter of 2015, we made a change to our customer count definition to better align to a global standard for business identification and tracking. Refer to the "Total customers" paragraph below for further details about the change. The change in customer count definition increased the upsell rate we had disclosed in the prior year from 35% to 43% for the three months ended September 30, 2014, and from 34% to 43% for the nine months ended September 30, 2014.

Total customers. We believe our total customer count is a key indicator of our market penetration, growth and future revenues. We have aggressively invested in, and intend to continue to invest in, our direct sales force and additional partnerships with our indirect sales channel in order to grow our customer base. Based on our new definition of customer count as described below, our total customer count was 2,804 and 2,176, as of September 30, 2015 and 2014, respectively.

In the first quarter of 2015, we changed our definition of customer count to better align to a global standard for business identification and tracking. Previously, we generally defined a customer as an entity with an active subscription contract as of the measurement date. In situations where a single contract applied to entities with multiple subsidiaries or divisions, universities or governmental organizations, each entity that had contracted for a separate production instance of our services was counted as a separate customer. Beginning on January 1, 2015, a customer is defined as an entity with a unique Dunn & Bradstreet Global Ultimate, or GULT, Data Universal Numbering System, or DUNS, and an active subscription contract as of the measurement date. The DUNS number is a global standard for business identification and tracking. We will make exceptions for holding companies, government entities and other organizations for which the GULT, in our judgment, does not accurately represent the ServiceNow customer. For example, while all U.S. government agencies roll up to "Government of the United States" under the GULT, we count each government agency that we contract with as a separate customer. Our customer count continues to exclude customers of our Express product offering, which is our standardized IT service management solution.

The change in customer count definition reduced our customer count as of September 30, 2014 by 338 customers. As total customer count is a factor used in the calculation of other metrics we disclose (upsell rate, number of customers with ACV greater than $1 million, annual total revenues per customer and average contract term for new customers, upsells and renewals), we have revised previously disclosed numbers for the impacted metrics to ensure comparability across the periods.

Number of customers with ACV greater than $1 million. We count the total number of customers with ACV greater than $1 million as of the end of the period. We had 206 and 127 customers with ACV greater than $1 million as of September 30, 2015 and 2014, respectively.

The number of deals with net new ACV greater than $1 million entered into during the three months ended September 30, 2015 and 2014 were 9 and 11, respectively and 26 and 24 during the nine months ended September 30, 2015 and 2014, respectively. We define net new ACV as ACV from new customers and upsells to existing customers, net of losses to those customers.

G2K customer count. The Global 2000, or G2K, customer count is defined as the total number of G2K companies in our customer base as of the end of the period. The Forbes Global 2000 is an annual ranking of the top 2000 public companies in the world by Forbes magazine. The ranking is based on a mix of four metrics: sales; profit; assets; and market value. The Forbes list is updated annually in the second quarter of the calendar year. Current and prior period G2K customer counts are based on the most recent list for comparability purposes. We adjust the G2K count for acquisitions, spin-offs, and other market activity to ensure the G2K customer count is accurately captured. For example, we add a G2K customer when a G2K company that is not a customer acquires a company in our existing customer base that is not a G2K company. When we enter into a contract with a G2K parent company, or any of its related subsidiaries, or any combination of entities within a G2K company, we count only one G2K customer. We do not count further penetration into entities within the G2K as a new customer in the G2K customer count. Our G2K customer count based on the most recent Forbes Global 2000 list and adjusted for acquisitions, spin-offs and other market activity was 605 and 506 as of September 30, 2015 and 2014, respectively.

Billings. We define billings as revenue recognized plus the change in total deferred revenue as presented on the consolidated statements of cash flows. We believe billings offers investors useful supplemental information regarding the performance of our business and will help investors better understand the sales volume and performance of our business.

A calculation of billings is provided below:

	Three Months Ended September 30,		% Change	Nine Months Ended September 30,		% Change
	2015	2014		2015	2014	
	(dollars in thousands)			(dollars in thousands)		
Billings:						
Total revenues	$261,150	$178,712	46 %	$719,830	$484,559	49 %
Change in deferred revenue from the consolidated statements of cash flows	25,255	29,039	(13)%	115,812	92,351	25 %
Total billings	$286,405	$207,751	38 %	$835,642	$576,910	45 %

Our international operations provide a significant portion of our total billings and revenues. As a result, the general strengthening of the U.S. Dollar relative to other major foreign currencies (primarily the Euro) from the first nine months of 2014 to the first nine months of 2015 had an unfavorable impact on our billings and revenues. For entities reporting in currencies other than the U.S. Dollar, if we had translated our results for the third quarter of 2015 at the exchange rates for the third quarter of 2014 rather than the actual exchange rates in effect during the third quarter of 2015, our total billings would have increased by an additional $16.2 million, with $15.7 million of the increase relating to an increase in total revenues and $0.5 million of the increase relating to the change in deferred revenue from the consolidated statements of cash flows. If we had translated our results for the first nine months of 2015 at the exchange rates for the first nine months of 2014 rather than the actual exchange rates in effect during the first nine months of 2015, our total billings would have increased by an additional $58.6 million, with $47.1 million of the increase relating to an increase in total revenues and $11.5 million of the increase relating to the change in deferred revenue from the consolidated statements of cash flows.

Average contract term. We calculate the average contract term for new customers, upsells, and renewals based on the term of those contracts entered into during the period weighted by their ACV. The average new customer contract term was 32 months for both the three months ended September 30, 2015 and 2014, and 31 months and 32 months for the nine months ended September 30, 2015 and 2014, respectively. The average upsell contract term was 28 and 25 months for the three months ended September 30, 2015 and 2014, respectively, and 25 months for both the nine months ended September 30, 2015 and 2014. The average renewal contract term was 23 months and 24 months for the three months ended September 30, 2015 and 2014, respectively, and 24 months and 26 months for the nine months ended September 30, 2015 and 2014, respectively. In the first quarter of 2015, we made a change to our customer count definition to better align to a global standard for business identification and tracking. Refer to the "Total customers" paragraph section above for further details of the change. The change in customer count definition decreased the average new customer contract term from 33 months as disclosed in the prior year to 32 months for the three months ended September 30, 2014, and from 34 months as disclosed in the prior year to 32 months for the nine months ended September 30, 2014. Average upsell contract term and average renewal contract term were not included in the financial results for the three and nine months ended September 30, 2014; therefore the change in customer count definition had no impact to prior year disclosure.

Components of Results of Operations

Revenues

Subscription revenues. Subscription revenues are primarily comprised of fees that give customers access to the ordered subscription service, related support and upgrades to the subscribed service during the subscription term. Pricing includes multiple instances, hosting and support services, data backup and disaster recovery services, as well as future upgrades, when and if available, offered during the subscription term. We typically invoice our customers for subscription fees in annual increments upon execution of the initial contract or subsequent renewal. Our contracts are generally non-cancelable during the subscription term, though a customer can terminate for breach if we materially fail to perform.

We generate sales directly through our sales team and, to a lesser extent, through our channel partners. Revenues from our direct sales organization and channel partners represented 89% and 11%, respectively, for the three months ended September 30, 2015, and 88% and 12%, respectively, for the three months ended September 30, 2014. Revenues from our direct sales organization and channel partners represented 89% and 11%, respectively, for the nine months ended September 30, 2015 and 87% and 13%, respectively, for the nine months ended 2014. Sales to our channel partners are made at a discount and revenues are recorded at the discounted price when all revenue recognition criteria are met. From time to time our channel partners also provide us referrals for which we pay a referral fee. We pay referral fees to channel partners and other third parties, which are typically 15% of the customer's ACV. The referral fees may vary depending on the level of activity the partner performs in the sales process. We include these fees in sales and marketing expense.

Professional services and other revenues. Professional services revenues consist of fees associated with the implementation and configuration of our subscription service. Our pricing for professional services are primarily on a time-and-materials basis. We generally invoice our professional services monthly in arrears based on actual hours and expenses incurred. Other revenues primarily include fees from customer training delivered on-site or publicly available classes, royalties from licensing training materials, attendance and sponsorship fees for our annual Knowledge user conference and other customer forums. Typical payment terms require our customers to pay us within 30 days of invoice.

Allocation of Overhead Costs

Overhead costs associated with office facilities, IT and certain depreciation related to non-cloud-based infrastructure are allocated to cost of revenues and operating expenses based on headcount. Facility costs associated with our data centers (included as part of data center capacity costs) as well as depreciation related to our cloud-based infrastructure hardware equipment are classified as cost of subscription revenues.

Cost of Revenues

Cost of subscription revenues. Cost of subscription revenues consists primarily of expenses related to hosting our services and providing support to our customers. These expenses are comprised of data center capacity costs, depreciation related to our cloud-based infrastructure hardware equipment, amortization of acquired developed technology intangibles, personnel related costs directly associated with our cloud-based infrastructure and customer support, including salaries, benefits, bonuses and stock-based compensation and allocated overhead.

Cost of professional services and other revenues. Cost of professional services and other revenues consists primarily of personnel related costs directly associated with our professional services and training departments, including salaries, benefits, bonuses and stock-based compensation, the costs of contracted third-party partners and allocated overhead.

Professional services associated with the implementation and configuration of our subscription services are performed directly by our services team, as well as by contracted third-party partners. Fees paid to third-party partners are primarily recognized as cost of revenues as the professional services are delivered. Cost of revenues associated with our professional services engagements contracted with third-party partners as a percentage of professional services and other revenues was 23% and 20% in the three months ended September 30, 2015 and 2014, respectively, and 19% and 16% for the nine months ended September 30, 2015 and 2014, respectively.

Sales and Marketing Expenses

Sales and marketing expenses consist primarily of personnel related expenses directly associated with our sales and marketing staff, including salaries, benefits, bonuses, commissions and stock-based compensation. Sales and marketing expenses also include third-party referral fees, marketing and promotional events, including our annual Knowledge user conference, online marketing, product marketing and allocated overhead.

Research and Development Expenses

Research and development expenses consist primarily of personnel related expenses directly associated with our research and development staff, including salaries, benefits, bonuses and stock-based compensation and allocated overhead.

General and Administrative Expenses

General and administrative expenses consist primarily of personnel related expenses for our executive, finance, legal, human resources and administrative personnel, including salaries, benefits, bonuses and stock-based compensation, external legal, accounting and other professional services fees, other corporate expenses and allocated overhead.

Provision for Income Taxes

Provision for income taxes consists of federal, state and foreign income taxes. Due to cumulative losses, we maintain a valuation allowance against our U.S. deferred tax assets as of September 30, 2015 and December 31, 2014. We consider all available evidence, both positive and negative, including but not limited to, earnings history, projected future outcomes, industry and market trends and the nature of each of the deferred tax assets in assessing the extent to which a valuation allowance should be applied against our U.S. deferred tax assets.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board, or FASB, issued an update to ASC 606 Revenue from Contracts with Customers, or ASC 606, that will supersede virtually all existing revenue guidance. Under this update, an entity is required to recognize revenue upon transfer of promised goods or services to customers, in an amount that reflects the expected consideration received in exchange for those goods or services. As such, an entity will need to use more judgment and make more estimates than under the current guidance. This update should be applied retrospectively either to each prior reporting period presented in the financial statements, or only to the most current reporting period presented in the financial statements with a cumulative effect adjustment recorded in the retained earnings. This update is effective for our interim and annual reporting periods beginning January 1, 2018. Early adoption is permitted for us on January 1, 2017. We are currently evaluating the impact of this update on our consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03, Simplifying the Presentation of Debt Issuance Costs. To simplify presentation of debt issuance costs, this new guidance requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. This guidance will become effective for financial statements issued for fiscal years beginning after December 15, 2015 and interim periods within those fiscal years. Early adoption is permitted. This ASU is not expected to have a material impact on our consolidated financial statements or disclosures.

Results of Operations

To enhance comparability, the following table sets forth our results of operations for the periods presented. The period-to-period comparison of financial results is not necessarily indicative of future results.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(in thousands)		(in thousands)	
Revenues:				
Subscription	$223,208	$150,367	$603,576	$400,466
Professional services and other	37,942	28,345	116,254	84,093
Total revenues	261,150	178,712	719,830	484,559
Cost of revenues(1):				
Subscription	46,053	37,925	133,889	102,357
Professional services and other	35,835	28,161	104,615	75,781
Total cost of revenues	81,888	66,086	238,504	178,138
Gross profit	179,262	112,626	481,326	306,421
Operating expenses(1):				
Sales and marketing	117,899	84,002	364,530	245,355
Research and development	55,822	39,683	158,946	106,232
General and administrative	33,581	23,440	93,357	69,985
Total operating expenses	207,302	147,125	616,833	421,572
Loss from operations	(28,040)	(34,499)	(135,507)	(115,151)
Interest and other expense, net	(11,791)	(5,949)	(21,851)	(17,143)
Loss before provision for income taxes	(39,831)	(40,448)	(157,358)	(132,294)
Provision for income taxes	1,199	602	3,690	2,430
Net loss	$(41,030)	$(41,050)	$(161,048)	$(134,724)

(1) Stock-based compensation included in the statements of operations above was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(in thousands)		(in thousands)	
Cost of revenues:				
Subscription	$5,951	$3,995	$17,183	$10,896
Professional services and other	5,804	3,572	16,788	9,188
Sales and marketing	26,011	14,956	74,690	36,382
Research and development	18,130	11,682	51,703	29,973
General and administrative	9,215	7,285	29,167	21,884

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Revenues:				
Subscription	85 %	84 %	84 %	83 %
Professional services and other	15	16	16	17
Total revenues	100	100	100	100
Cost of revenues:				
Subscription	18	21	19	21
Professional services and other	14	16	15	16
Total cost of revenues	32	37	34	37
Gross profit	68	63	66	63
Operating expenses:				
Sales and marketing	45	47	51	50
Research and development	21	22	22	22
General and administrative	13	13	13	14
Total operating expenses	79	82	86	86
Loss from operations	(11)	(19)	(19)	(24)
Interest and other expense, net	(5)	(4)	(2)	(3)
Loss before provision for income taxes	(16)	(23)	(21)	(27)
Provision for income taxes	—	—	1	1
Net loss	(16)%	(23)%	(22)%	(28)%

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(in thousands)		(in thousands)	
Revenues by geography				
North America	$181,293	$120,435	$504,326	$329,660
EMEA [1]	61,663	46,521	165,996	125,021
Asia Pacific and other	18,194	11,756	49,508	29,878
Total revenues	$261,150	$178,712	$719,830	$484,559

(1) Europe, the Middle East and Africa

Comparison of the Three Months Ended September 30, 2015 and 2014

Revenues

	Three Months Ended September 30,		% Change
	2015	2014	
	(dollars in thousands)		
Revenues:			
Subscription	$223,208	$150,367	48 %
Professional services and other	37,942	28,345	34 %
Total revenues	$261,150	$178,712	46 %
Percentage of revenues:			
Subscription	85 %	84	