



**Palo Alto Networks, Inc.  
Fiscal 2017 Annual Report**



Dear Palo Alto Networks stockholders:

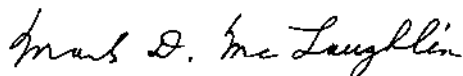
I am very pleased to report to you our fiscal year 2017 performance. It was a year highlighted by our industry-leading revenue growth, strong cash flow generation, new and expanding go-to-market and technology partnerships, industry recognition, and the continued delivery of security capabilities that extend and enhance our Next-Generation Security Platform. Our success is built upon our unwavering focus on innovation and our dedication to protecting our customers' digital way of life.

During fiscal year 2017 we:

- Reported revenue of \$1.8 billion, which grew 28 percent for the year; billings of \$2.3 billion, which grew 20 percent for the year; and cash flow from operations of \$869 million, which grew 32 percent for the year.
- Added more than 8,500 customers. We are now privileged to serve more than 42,500 customers across diverse verticals and geographies, including more than 1,250 of the Global 2000.
- Repurchased approximately 3.3 million shares under a repurchase authorization of \$1 billion.
- Expanded the preventative capabilities of Traps advanced endpoint protection with version 4.0. Included in the release was the addition of support for macOS, plus strengthened malware and exploit prevention capabilities, including several new prevention modules designed to detect and stop ransomware and other advanced threats.
- Acquired LightCyber with its highly automated analytics that use sophisticated machine learning to quickly, efficiently, and accurately identify attacks based on behavioral anomalies in the network. We expect to offer LightCyber integrated into our Next-Generation Security Platform by the end of calendar year 2017.
- Delivered the largest product launch in our history in February 2017 when we introduced PAN-OS 8.0, our new operating system with more than 70 new features; six new hardware appliances designed to enable customers to deploy next-generation security from large data centers to small branches; three new VM-Series models; and the industry's first multi-method, scalable, and automated approach to prevent credential-based theft at the network layer.
- And, announced at Ignite, our annual user conference, the introduction of innovation delivered to the market in the first fiscal quarter of 2018, including:
  - o GlobalProtect cloud service, enabling customers to extend the protections of our Next-Generation Security Platform to remote networks and mobile users by operationalizing the deployment with a cloud-based security infrastructure.
  - o And, Palo Alto Networks Logging Service, a cloud-based offering for collecting context-rich, enhanced logs generated by our security offerings. The Logging Service allows customers to collect ever-expanding rates of data without needing to plan for, deploy, or operate local compute and storage.

For over a decade, we have been driving major evolutions in security that deliver increasingly high rates of consistent prevention regardless of where data may reside, and marrying innovation with a consumption model that overcomes legacy siloed, expensive, and people-intensive models. These innovations have built on each other and in June 2017 we announced the next disruption of the security industry—the Palo Alto Networks Application Framework which we expect to deliver in early calendar 2018. This open and flexible framework will continue the evolution of our Next-Generation Security Platform by enabling Palo Alto Networks, third-party developers, and customers to rapidly build and deliver innovative cloud-based security offerings as an extension of the Next-Generation Security Platform customers already own and operate. We are excited about this opportunity to drive further disruption in the market and to continue to acquire market share.

Fiscal year 2017 was another record year for Palo Alto Networks and I would like to thank our stockholders, customers, partners, and employees for their continued support.



Mark D. McLaughlin  
Chairman and CEO  
Palo Alto Networks, Inc.  
October 2017

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**Palo Alto Networks, Inc.  
2017 Proxy Statement**

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**PALO ALTO NETWORKS, INC.**  
**3000 TANNERY WAY**  
**SANTA CLARA, CALIFORNIA 95054**

**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS**  
**To Be Held at 10:00 a.m. Pacific Standard Time on Friday, December 8, 2017**

Dear Stockholders of Palo Alto Networks, Inc.:

The 2017 annual meeting of stockholders and any postponements, adjournments or continuations thereof (the "Annual Meeting") of Palo Alto Networks, Inc., a Delaware corporation, will be held on **Friday, December 8, 2017 at 10:00 a.m. Pacific Standard Time**, at our headquarters, located at 3000 Tannery Way, Santa Clara, California 95054, for the following purposes, as more fully described in the accompanying proxy statement:

1. To elect three Class III directors to serve until our 2020 annual meeting of stockholders and until their successors are duly elected and qualified;
2. To ratify the appointment of Ernst & Young LLP as our independent registered public accounting firm for our fiscal year ending July 31, 2018;
3. To approve, on an advisory basis, the compensation of our named executive officers;
4. To approve the Palo Alto Networks, Inc. Executive Incentive Plan;
5. To consider and vote upon a stockholder proposal regarding a diversity report, if properly presented at the annual meeting; and
6. To transact any and all such other business that may properly come before the Annual Meeting.

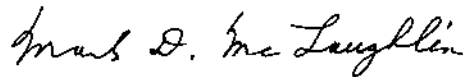
Our board of directors has fixed the close of business on October 16, 2017 as the record date for the Annual Meeting. Only stockholders of record on October 16, 2017 are entitled to notice of and to vote at the Annual Meeting. Further information regarding voting rights and the matters to be voted upon is presented in the accompanying proxy statement.

On or about October 23, 2017, we expect to mail to our stockholders a Notice of Internet Availability of Proxy Materials (the "Notice") containing instructions on how to access our proxy statement and our annual report. The Notice provides instructions on how to vote via the Internet or by telephone and includes instructions on how to receive a paper copy of our proxy materials by mail. The accompanying proxy statement and our annual report can be accessed directly at the following Internet address: <http://www.proxyvote.com>. All you have to do is enter the control number located on your proxy card.

**YOUR VOTE IS IMPORTANT. Whether or not you plan to attend the Annual Meeting, we urge you to submit your vote via the Internet, telephone or mail as soon as possible to ensure your shares are represented.**

We appreciate your continued support of Palo Alto Networks, Inc. and look forward to either greeting you personally at the Annual Meeting or receiving your proxy.

By order of the Board of Directors,



Mark McLaughlin  
Chairman and Chief Executive Officer  
Santa Clara, California  
October 23, 2017

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**PALO ALTO NETWORKS, INC.**

**PROXY STATEMENT  
FOR 2017 ANNUAL MEETING OF STOCKHOLDERS  
To Be Held at 10:00 a.m. Pacific Standard Time on Friday, December 8, 2017**

This proxy statement and your proxy card are furnished in connection with the solicitation of proxies by our board of directors for use in connection with the 2017 annual meeting of stockholders of Palo Alto Networks, Inc. (“Palo Alto Networks”), a Delaware corporation, and any postponements, adjournments or continuations thereof (the “Annual Meeting”). The Annual Meeting will be held on Friday, December 8, 2017 at 10:00 a.m. Pacific Standard Time, at our headquarters, located at 3000 Tannery Way, Santa Clara, California 95054. A Notice of Internet Availability of Proxy Materials (the “Notice”) containing instructions on how to access this proxy statement and our annual report is first being mailed on or about October 23, 2017 to all stockholders entitled to vote at the Annual Meeting. Information contained on, or that can be accessed through, our website is not intended to be incorporated by reference into this proxy statement and references to our website address in this proxy statement are inactive textual references only.

The information provided in the “question and answer” format below is for your convenience only and is merely a summary of the information contained in this proxy statement. You should read this entire proxy statement carefully.

**What matters am I voting on?**

You will be voting on:

- the election of three Class III directors to serve until our 2020 annual meeting of stockholders and until their successors are duly elected and qualified;
- a proposal to ratify the appointment of Ernst & Young LLP as our independent registered public accounting firm for our fiscal year ending July 31, 2017;
- a proposal to approve, on an advisory basis, the compensation of our named executive officers;
- a proposal to approve the Palo Alto Networks, Inc. Executive Incentive Plan;
- a stockholder proposal regarding a diversity report, if properly presented at the Annual Meeting; and
- any other business as may properly come before the Annual Meeting.

**How does the board of directors recommend I vote on these proposals?**

Our board of directors recommends a vote:

- “FOR” the election of Frank Calderoni, Carl Eschenbach and Daniel J. Warmenhoven as Class III directors;
- “FOR” the ratification of the appointment of Ernst & Young LLP as our independent registered public accounting firm for our fiscal year ending July 31, 2018;
- “FOR” the approval, on an advisory basis, of the compensation of our named executive officers;
- “FOR” the approval of the Palo Alto Networks, Inc. Executive Incentive Plan (“Executive Incentive Plan”); and
- “AGAINST” the stockholder proposal regarding a diversity report.

**Who is entitled to vote?**

Holders of our common stock as of the close of business on October 16, 2017 (the “Record Date”), may vote at the Annual Meeting. As of the Record Date, 91,977,343 shares of our common stock were outstanding. In

deciding all matters at the Annual Meeting, each stockholder will be entitled to one vote for each share of our common stock held by them on the Record Date. Stockholders may not cumulate votes in the election of directors.

*Registered Stockholders.* If shares of our common stock are registered directly in your name with our transfer agent, you are considered the stockholder of record with respect to those shares, and the Notice was provided to you directly by us. As the stockholder of record, you have the right to grant your voting proxy directly to the individuals listed on the proxy card or to vote in person at the Annual Meeting. Throughout this proxy statement, we refer to these registered stockholders as “stockholders of record.”

*Street Name Stockholders.* If shares of our common stock are held on your behalf in a brokerage account or by a bank or other nominee, you are considered to be the beneficial owner of shares that are held in “street name,” and the Notice was forwarded to you by your broker, bank or other nominee, who is considered the stockholder of record with respect to those shares. As the beneficial owner, you have the right to direct your broker, bank or other nominee as to how to vote your shares. Beneficial owners are also invited to attend the Annual Meeting. However, since a beneficial owner is not the stockholder of record, you may not vote your shares in person at the Annual Meeting unless you follow your broker, bank, or other nominee’s procedures for obtaining a legal proxy and present your legal proxy at the Annual Meeting. If you request a printed copy of our proxy materials by mail, your broker, bank or other nominee will provide a voting instruction form for you to use. Throughout this proxy statement, we refer to stockholders who hold their shares through a broker, bank or other nominee as “street name stockholders.”

### **Can I attend the Annual Meeting?**

- You may attend the Annual Meeting if you are a stockholder of record or a beneficial owner as of October 16, 2017. All stockholders must bring proof of identification, such as a driver’s license or passport, for admission to the Annual Meeting.
- If you are a stockholder of record, your name will be verified against the list of stockholders of record prior to admittance to the Annual Meeting.
- If you are a street name stockholder, you will be asked to provide proof of beneficial ownership as of the Record Date, such as a brokerage account statement, a copy of the Notice or voting instruction card provided by the broker, bank or other nominee that is the stockholder of record, or other similar evidence of beneficial ownership, as well as proof of identification, for admission. If you wish to be able to vote in person at the Annual Meeting, you must obtain a legal proxy from your broker, bank or other nominee and present it to the inspector of elections with your ballot at the Annual Meeting.
- Registration will begin at 9:30 a.m. Pacific Standard Time on the date of the Annual Meeting. If you do not provide proof of identification and comply with the other procedures outlined above, you may not be admitted to the Annual Meeting.
- Cameras, recording devices and other electronic devices will not be permitted at the Annual Meeting.
- You may contact us at (408) 753-4000 for directions to the Annual Meeting.

### **How do I vote?**

If you are a stockholder of record, there are four ways to vote:

- by Internet at <http://www.proxyvote.com>, 24 hours a day, seven days a week (have your proxy card in hand when you visit the website);
- by toll-free telephone at 1-800-690-6903 until 11:59 p.m. Eastern Standard Time, on December 7, 2017 (have your proxy card in hand when you call);

- by completing and mailing your proxy card so it is received prior to the Annual Meeting (if you received printed proxy materials); or
- by written ballot at the Annual Meeting.

Even if you plan to attend the Annual Meeting, we recommend that you also vote by proxy so that your vote will be counted if you later decide not to attend the Annual Meeting.

If you are a street name stockholder, you will receive voting instructions from your broker, bank or other nominee. You must follow the voting instructions provided by your broker, bank or other nominee in order to direct your broker, bank or other nominee on how to vote your shares. Street name stockholders should generally be able to vote by returning a voting instruction form, or by telephone or on the Internet. However, the availability of telephone and Internet voting will depend on the voting process of your broker, bank or other nominee. As discussed above, if you are a street name stockholder, you may not vote your shares live at the Annual Meeting unless you obtain a legal proxy from your broker, bank or other nominee.

### **Can I change my vote?**

Yes. If you are a stockholder of record, you can change your vote or revoke your proxy any time before the Annual Meeting by:

- entering a new vote by Internet or by telephone;
- returning a later-dated proxy card;
- notifying the Corporate Secretary of Palo Alto Networks, in writing, at the address listed on the front page of this proxy statement; or
- completing a written ballot at the Annual Meeting (although attendance at the Annual Meeting will not, by itself, revoke a proxy).

If you are a street name stockholder, your broker, bank or other nominee can provide you with instructions on how to change your vote or revoke your proxy.

### **What is the effect of giving a proxy?**

Proxies are solicited by and on behalf of our board of directors. The persons named in the proxy have been designated as proxies by our board of directors. When a proxy card is properly dated, executed and returned, the shares represented by such proxies will be voted at the Annual Meeting in accordance with the instruction of the stockholder. If a proxy card is signed, but no specific instructions are given, the shares represented by such proxy card will be voted in accordance with the recommendations of our board of directors, as described above. If any matters not described in this proxy statement are properly presented at the Annual Meeting, the proxy holders will use their own judgment to determine how to vote the shares subject to proxies. If the Annual Meeting is adjourned, the proxy holders can vote your shares subject to proxies when the Annual Meeting is rescheduled, unless you have properly revoked your proxy instructions, as described above.

### **Why did I receive the Notice instead of a full set of proxy materials?**

In accordance with the rules of the Securities and Exchange Commission (“SEC”), we have elected to furnish our proxy materials, including this proxy statement and our annual report, primarily via the Internet. The Notice containing instructions on how to access our proxy materials is first being mailed on or about October 23, 2017 to all stockholders entitled to vote at the Annual Meeting. Stockholders may request to receive all future proxy materials in printed form by mail or electronically by e-mail by following the instructions contained in the Notice. We encourage stockholders to take advantage of the availability of our proxy materials on the Internet to help reduce the environmental impact of our annual meetings of stockholders.

## **What is a quorum?**

A quorum is the minimum number of shares required to be present for the Annual Meeting to be properly held under our amended and restated bylaws and Delaware law. The presence, in person or by proxy, of a majority of all issued and outstanding shares of our common stock entitled to vote at the Annual Meeting will constitute a quorum at the Annual Meeting. A proxy submitted by a stockholder may indicate that all or a portion of the shares represented by the proxy are not being voted (“stockholder withholding”) with respect to a particular matter. Similarly, a broker may not be permitted to vote shares held in street name on a particular matter in the absence of instructions from the beneficial owner of such shares (“broker non-vote”). See the section titled “How may my broker, bank or other nominee vote my shares if I fail to timely provide voting instructions?” The shares of our common stock subject to a proxy that are not being voted on a particular matter because of either stockholder withholding or a broker non-vote will count for purposes of determining the presence of a quorum. Abstentions are also counted in the determination of a quorum.

## **How many votes are needed for approval of each proposal?**

- *Proposal No. 1:* The election of directors requires a plurality vote of the shares of our common stock present in person or by proxy at the Annual Meeting and entitled to vote thereon to be approved. “Plurality” means that the nominees who receive the largest number of votes cast “for” such nominees are elected as directors. As a result, any shares not voted “for” a particular nominee (whether as a result of stockholder abstention or a broker non-vote) will not be counted in such nominee’s favor and will have no effect on the outcome of the election. You may vote “for” or “withhold” on each of the nominees for election as a director.
- *Proposal No. 2:* The ratification of the appointment of Ernst & Young LLP as our independent registered public accounting firm for our fiscal year ending July 31, 2018 requires the affirmative vote of a majority of the shares of our common stock present in person or by proxy at the Annual Meeting and entitled to vote thereon to be approved. You may vote “for,” “against,” or “abstain” with respect to this proposal. Abstentions are considered votes present and entitled to vote on this proposal, and thus will have the same effect as a vote “against” this proposal. Broker non-votes will have no effect on the outcome of this proposal.
- *Proposal No. 3:* The approval, on an advisory basis, of the compensation of our named executive officers requires the affirmative vote of a majority of the shares of our common stock present in person or by proxy at the Annual Meeting and entitled to vote thereon to be approved. You may vote “for,” “against,” or “abstain” with respect to this proposal. Abstentions are considered votes present and entitled to vote on this proposal, and thus will have the same effect as votes “against” this proposal. Broker non-votes will have no effect on the outcome of this proposal. Although the advisory vote is non-binding, our board of directors values stockholders’ opinions. The compensation committee will review the results of the vote and, consistent with our record of stockholder responsiveness, consider stockholders’ concerns and take into account the outcome of the vote when considering future decisions concerning our executive compensation program.
- *Proposal No. 4:* The approval of the Executive Incentive Plan requires the affirmative vote of a majority of the shares of our common stock present in person or by proxy at the Annual Meeting and entitled to vote thereon to be approved. You may vote “for,” “against,” or “abstain” with respect to this proposal. Abstentions are considered votes present and entitled to vote on this proposal, and thus will have the same effect as a vote “against” this proposal. Broker non-votes will have no effect on the outcome of this proposal.
- *Proposal No. 5:* The stockholder proposal requesting additional diversity disclosure requires the affirmative vote of a majority of the shares of our common stock present in person or by proxy at the Annual Meeting and entitled to vote thereon to be approved. You may vote “for,” “against,” or “abstain” with respect to this proposal. Abstentions are considered votes present and entitled to vote on

this proposal, and thus will have the same effect as votes “against” this proposal. Broker non-votes will have no effect on the outcome of this proposal.

**How are proxies solicited for the Annual Meeting?**

Our board of directors is soliciting proxies for use at the Annual Meeting. All expenses associated with this solicitation will be borne by us. We will reimburse brokers, banks or other nominees for reasonable expenses that they incur in sending our proxy materials to you if a broker, bank or other nominee holds your shares of our common stock. In addition to using the internet, our directors, officers and employees may solicit proxies in person and by mail, telephone, facsimile, or electronic transmission, for which they will not receive any additional compensation. We have retained Saratoga Proxy Consulting LLC to assist us in soliciting proxies for a fee of \$15,000, plus reasonable out-of-pocket expenses incurred in the process of soliciting proxies.

**How may my broker, bank or other nominee vote my shares if I fail to timely provide voting instructions?**

Brokerage firms, banks or other nominees holding shares of our common stock in street name for beneficial owners are generally required to vote such shares in the manner directed by the beneficial owner. In the absence of timely directions, your broker, bank or other nominee will have discretion to vote your shares on our sole “routine” matter, the proposal to ratify the appointment of Ernst & Young LLP as our independent registered public accounting firm for our fiscal year ending January 31, 2018. Your broker will not have discretion to vote on any other proposals, which are “non-routine” matters, absent direction from you.

**Is my vote confidential?**

Proxy instructions, ballots, and voting tabulations that identify individual stockholders are handled in a manner that protects your voting privacy. Your vote will not be disclosed either within Palo Alto Networks or to third parties, except as necessary to meet applicable legal requirements, to allow for the tabulation of votes and certification of the vote, or to facilitate a successful proxy solicitation. Occasionally, stockholders provide written comments on their proxy cards, which may be forwarded to management and our board of directors.

**Where can I find the voting results of the Annual Meeting?**

We will announce preliminary voting results at the Annual Meeting. We will also disclose voting results on a Current Report on Form 8-K that we will file with the SEC within four business days after the Annual Meeting. If final voting results are not available to us in time to file a Current Report on Form 8-K within four business days after the Annual Meeting, we will file a Current Report on Form 8-K to publish preliminary voting results and will provide the final voting results in an amendment to the Current Report on Form 8-K as soon as they become available.

**I share an address with another stockholder, and we received only one paper copy of the proxy materials. How may I obtain an additional copy of the proxy materials?**

We have adopted a procedure called “householding,” which the SEC has approved. Under this procedure, we deliver a single copy of the Notice, and if applicable, our proxy materials, to multiple stockholders who share the same address unless we receive contrary instructions from one or more of the stockholders sharing the same address. This procedure reduces our printing costs, mailing costs, and fees. Stockholders who participate in householding will continue to be able to access and receive separate copies of the Notice, or if applicable, our proxy materials. Upon written or oral request, we will deliver promptly separate copies of the Notice and, if applicable, our proxy materials, to any stockholder at a shared address which we delivered a single copy of any of these materials. To receive a separate copy, or, if a stockholder is receiving multiple copies, to request that we only send a single copy of the Notice or, if applicable, our proxy materials, stockholders may contact us at the following: Palo Alto Networks, Inc., Attention: Investor Relations, 3000 Tannery Way, Santa Clara, California 95054 or Tel: (408) 753-4000.

Stockholders who hold shares of our common stock in street name may contact their brokerage firm, bank, broker-dealer or other similar organization to request information about householding.

**What is the deadline to propose actions for consideration at next year's annual meeting of stockholders or to nominate individuals to serve as directors?**

*Stockholder Proposals*

Stockholders may present proper proposals for inclusion in our proxy statement and for consideration at the next annual meeting of stockholders by submitting their proposals in writing to our Corporate Secretary in a timely manner. For a stockholder proposal to be considered for inclusion in our proxy statement for our 2018 annual meeting of stockholders, our Corporate Secretary must receive the written proposal at our principal executive offices not later than June 25, 2018. In addition, stockholder proposals must comply with the requirements of Rule 14a-8 under the Securities Exchange Act of 1934, as amended (the "Exchange Act") regarding the inclusion of stockholder proposals in company-sponsored proxy materials. Stockholder proposals should be addressed to:

Palo Alto Networks, Inc., Attention: Corporate Secretary, 3000 Tannery Way, Santa Clara, California 95054.

Our amended and restated bylaws also establish an advance notice procedure for stockholders who wish to present a proposal before an annual meeting of stockholders but do not intend for the proposal to be included in our proxy statement. Our amended and restated bylaws provide that the only business that may be conducted at an annual meeting is business that is (i) specified in our proxy materials with respect to such annual meeting, (ii) otherwise properly brought before the annual meeting by or at the direction of our board of directors, or (iii) properly brought before the annual meeting by a stockholder of record entitled to vote at the annual meeting who has delivered timely written notice to our Corporate Secretary, which notice must contain the information specified in our amended and restated bylaws. To be timely for our 2018 annual meeting of stockholders, our Corporate Secretary must receive the written notice at our principal executive offices:

- not earlier than the close of business August 9, 2018; and
- not later than the close of business on September 8, 2018.

In the event that we hold our 2018 annual meeting of stockholders more than 30 days before or more than 60 days after the one-year anniversary of the Annual Meeting, then notice of a stockholder proposal that is not intended to be included in our proxy statement must be received no earlier than the close of business on the 120th day before such annual meeting and no later than the close of business on the later of the following two dates:

- the 90th day prior to such annual meeting; or
- the 10th day following the day on which public announcement of the date of such annual meeting is first made.

If a stockholder who has notified us of his, her or its intention to present a proposal at an annual meeting does not appear to present his, her or its proposal at such annual meeting, we are not required to present the proposal for a vote at such annual meeting.

*Recommendation and Nomination of Director Candidates*

You may recommend director candidates for consideration by our nominating and corporate governance committee. Any such recommendations should include, among other requirements, information about the candidate, a statement of support by the recommending stockholder, evidence of the recommending stockholder's ownership of our common stock and a signed letter from the candidate confirming willingness to



serve on our board of directors, and should be directed to our Corporate Secretary at the address set forth above. For additional information regarding stockholder recommendations for director candidates, see the section titled “Board of Directors and Corporate Governance—Stockholder Recommendations for Nominations to the Board of Directors.”

In addition, our amended and restated bylaws permit stockholders to nominate directors for election at an annual meeting of stockholders. To nominate a director, the stockholder must provide the information required by our amended and restated bylaws. In addition, the stockholder must give timely notice to our Corporate Secretary in accordance with our amended and restated bylaws, which, in general, require that the notice be received by our Corporate Secretary within the time periods described above under the section titled “Stockholder Proposals” for stockholder proposals that are not intended to be included in a proxy statement.

#### *Availability of Bylaws*

A copy of our amended and restated bylaws may be obtained by accessing our public filings on the SEC’s website at [www.sec.gov](http://www.sec.gov). You may also contact our Corporate Secretary at our principal executive offices for a copy of the relevant bylaw provisions regarding the requirements for making stockholder proposals and nominating director candidates.

**PROPOSAL NO. 1  
ELECTION OF DIRECTORS**

Our business affairs are managed under the direction of our board of directors, which is currently composed of eleven members. Nine of our directors are independent within the meaning of the listing standards of the New York Stock Exchange (“NYSE”) and SEC rules and regulations. Our board of directors is divided into three staggered classes of directors. At each annual meeting of stockholders, a class of directors will be elected for a three-year term to succeed the same class whose term is then expiring.

Each director’s term continues until the election and qualification of his or her successor, or such director’s earlier death, resignation, or removal. Any increase or decrease in the number of directors will be distributed among the three classes so that, as nearly as possible, each class will consist of one-third of our directors. This classification of our board of directors may have the effect of delaying or preventing changes in control of our company.

The names and certain other information as of October 23, 2017 for each of the nominees for election as a director, for each of the continuing members of the board of directors are set forth below.

	<u>Class</u>	<u>Age</u>	<u>Position</u>	<u>Director Since</u>	<u>Current Term Expires</u>	<u>Expiration of Term For Which Nominated</u>
<b>Nominees</b>						
Frank Calderoni (1)	III	60	Director	2016	2017	2020
Carl Eschenbach (2) (3)	III	50	Director	2013	2017	2020
Daniel J. Warmenhoven (2) (3) (4)	III	66	Director	2012	2017	2020
<b>Continuing Directors</b>						
John M. Donovan (1)	I	57	Director	2012	2018	—
Stanley J. Meresman (1)	I	70	Director	2014	2018	—
Nir Zuk	I	46	Director and Chief Technology Officer	2005	2018	—
Mary Pat McCarthy (1)	I	62	Director	2016	2018	—
Mark D. McLaughlin	II	51	Chairman and Chief Executive Officer	2011	2019	—
Asheem Chandna (2) (3)	II	53	Director	2005	2019	—
James J. Goetz (2) (3)	II	51	Director	2005	2019	—
Sridhar Ramaswamy (3)	II	51	Director	2017	2019	—

- (1) Member of our audit committee
- (2) Member of our compensation committee
- (3) Member of our nominating and corporate governance committee
- (4) Lead Independent Director

**Nominees for Director**

*Frank Calderoni* has served as a member of our board of directors since February 2016. Since January 2017, Mr. Calderoni has served as President, Chief Executive Officer and a director of Anaplan, Inc., a planning and performance management platform. From June 2015 to January 2017, Mr. Calderoni served as Executive Vice President, Operations and Chief Financial Officer of Red Hat, Inc., a software company. From May 2004 to January 2015, Mr. Calderoni served in various positions at Cisco Systems, Inc., a multinational technology company, including as Executive Vice President and Chief Financial Officer. Mr. Calderoni currently serves on the board of directors of Adobe Systems Incorporated, a global software company, and has previously served on the board of directors of Nimble Storage, Inc., a data storage company. Mr. Calderoni holds a B.S. in Accounting

and Finance from Fordham University and an M.B.A. from Pace University. Mr. Calderoni was selected to serve on our board of directors because of his extensive financial and accounting expertise from his current and prior experience as Chief Financial Officer of various public companies, a deep understanding of financial reporting rules and regulations as well as his extensive experience in the technology industry.

*Carl Eschenbach* has served as a member of our board of directors since May 2013. Mr. Eschenbach has been a general partner at Sequoia Capital Operations, LLC, a venture capital firm, since April 2016, and continues to serve as a strategic advisor to VMware, Inc., a provider of cloud and virtualization software and services. Prior to joining Sequoia Capital Operations, LLC, Mr. Eschenbach served as Chief Operating Officer and President of VMware, Inc. a role he held from December 2012 to February 2016. Mr. Eschenbach previously served as VMware's President and Chief Operating Officer from April 2012 to December 2012, as VMware's Co-President, Customer Operations from January 2011 to April 2012 and as VMware's Executive Vice President of Worldwide Field Operations from May 2005 to January 2011. Prior to joining VMware in 2002, he was Vice President of North America Sales at Inktomi from 2000 to 2002. Mr. Eschenbach also held various sales management positions with 3Com Corporation, Lucent Technologies Inc. and EMC. Mr. Eschenbach was selected to serve on our board of directors because of his extensive experience in the technology industry and his previous public company management experience.

*Daniel J. Warmenhoven* has served as the Lead Independent Director of our board of directors since March 2012. From October 1994 to August 2009, Mr. Warmenhoven was Chief Executive Officer at NetApp, Inc., a provider of computer storage and data management, and on their board of directors as Executive Chairman from August 2009 through September 2014. Mr. Warmenhoven previously served on the board of directors of Aruba Networks, a vendor of data networking solutions. Mr. Warmenhoven holds a B.S. degree in Electrical Engineering from Princeton University. Mr. Warmenhoven was selected to serve on our board of directors because of his extensive experience in the technology industry and his public company management and board experience.

If you are a stockholder of record and you sign your proxy card or vote by telephone or over the Internet but do not give instructions with respect to the voting of directors, your shares will be voted "FOR" the re-election of Messrs. Calderoni, Eschenbach and Warmenhoven. We expect that each of Messrs. Calderoni, Eschenbach and Warmenhoven will accept such nomination; however, in the event that a director nominee is unable or declines to serve as a director at the time of the Annual Meeting, the proxies will be voted for any nominee who shall be designated by our board of directors to fill such vacancy. If you wish to give specific instructions with respect to the voting of directors, you may do so by indicating your instructions on your proxy card or when you vote by telephone or over the Internet. If you are a street name stockholder and you do not give voting instructions to your broker or nominee, your shares will not be voted on this matter.

**THE BOARD OF DIRECTORS RECOMMENDS A VOTE "FOR" EACH  
OF THE NOMINEES NAMED ABOVE.**

## BOARD OF DIRECTORS AND CORPORATE GOVERNANCE

### Continuing Directors

*Asheem Chandna* has served as a member of our board of directors since April 2005. Mr. Chandna has been a Partner at Greylock Partners, a venture capital firm, since September 2003, where he focuses on investments in enterprise IT, including security products. From April 2003 to June 2013, Mr. Chandna was a director of Imperva, Inc., a provider of cyber security solutions. From April 1996 to December 2002, Mr. Chandna was Vice President, Business Development and Product Management at Check Point Software. Mr. Chandna currently serves on the board of directors of a number of privately held companies. Mr. Chandna holds a B.S. in Electrical Engineering and an M.S. in Computer Engineering from Case Western Reserve University. Mr. Chandna was selected to serve on our board of directors because of his specific professional experience with Internet security products, his extensive background with enterprise IT companies, and his public and private company board experience.

*John M. Donovan* has served as a member of our board of directors since September 2012. Mr. Donovan has worked at AT&T Inc., a provider of telecommunication services, since April 2008, first as Chief Technology Officer and currently as Chief Executive Officer—AT&T Communications. From November 2006 to April 2008, Mr. Donovan was Executive Vice President of Product, Sales, Marketing and Operations at Verisign. From November 2000 to November 2006, Mr. Donovan served as Chairman and CEO of inCode Telecom Group Inc., a provider of strategy and consulting services to the telecommunications industry. Prior to joining inCode, Mr. Donovan was a Partner with Deloitte Consulting where he was the Americas industry practice director for telecommunications. Mr. Donovan holds a B.S. in Electrical Engineering from the University of Notre Dame and an M.B.A. from the University of Minnesota. Mr. Donovan was selected to serve on our board of directors because of his extensive experience in the telecommunications industry.

*James J. Goetz* has served as a member of our board of directors since April 2005. Mr. Goetz has been a managing member of Sequoia Capital Operations, LLC, a venture capital firm, since June 2004, where he focuses on cloud, mobile, and enterprise companies. Mr. Goetz currently serves on the board of directors of several privately held companies. Mr. Goetz has previously served on the boards of directors of Barracuda Networks, Inc., a data security and storage company from 2009 to 2017, Nimble Storage, Inc., a data storage company, from 2007 to 2017, Jive Software, Inc., a provider of social business software, from 2007 until 2015, and Ruckus Wireless, Inc., a manufacturer of wireless (Wi-Fi) networking equipment, from 2012 until 2015. Mr. Goetz holds an M.S. in Electrical Engineering with a concentration in Computer Networking from Stanford University and a B.S. in Electrical Engineering with a concentration in Computer Engineering from the University of Cincinnati. Mr. Goetz was selected to serve on our board of directors because of his deep experience with the venture capital industry and providing guidance and counsel to a wide variety of Internet and technology companies.

*Mary Pat McCarthy* has served as a member of our board of directors since October 2016. Ms. McCarthy, now retired, served as Vice Chair of KPMG LLP, the U.S. member firm of the global audit, tax and advisory services firm, until 2011 after attaining such position in 1998. She joined KPMG LLP in 1977 and became a partner in 1987. She held numerous senior leadership positions in the firm, including Executive Director of the KPMG Audit Committee Institute from 2008 to 2011, Leader of the KPMG Client Care Program from 2007 to 2008, U.S. Leader, Industries and Markets from 2005 to 2006, and Global Leader, Information, Communication and Entertainment Practice from 1998 to 2004. Ms. McCarthy also served on KPMG's Management and Operations Committees. Ms. McCarthy earned a Bachelor of Science degree in Business Administration from Creighton University and completed the University of Pennsylvania Wharton School's KPMG International Development Program. Ms. McCarthy serves as a director of Andeavor Corporation (formerly Tesoro Corporation), a global energy corporation and Mutual of Omaha, an insurance and banking company. Ms. McCarthy was selected to serve on our board of directors due, in part, to her background as chairperson of the Audit Committee of each of Andeavor Corporation and Mutual of Omaha and her financial and accounting expertise from her prior extensive experience as the Vice Chair of KPMG LLP.

*Mark D. McLaughlin* has served as our Chief Executive Officer and as a member of our board of directors since August 2011, and as the Chairman of our board of directors since April 2012. From July 2011 through August 2016, Mr. McLaughlin also served as our President. From August 2009 through July 2011, Mr. McLaughlin served as President and Chief Executive Officer and as a director at VeriSign, Inc., a provider of Internet infrastructure services, and from January 2009 to August 2009, Mr. McLaughlin served as President and Chief Operating Officer at VeriSign. From February 2000 through November 2007, Mr. McLaughlin served in several roles at VeriSign, including as Executive Vice President, Products and Marketing. Prior to joining VeriSign, Mr. McLaughlin was Vice President, Sales and Business Development at Signio Inc., an Internet payments company acquired by VeriSign in February 2000. In January 2011, President Barack Obama appointed Mr. McLaughlin to serve on the President's National Security Telecommunications Advisory Committee. Mr. McLaughlin currently serves on the board of directors of Qualcomm, Inc., a global semiconductor company that designs and markets wireless telecommunications products and services, and previously served on the board of directors of Opower, Inc., a provider of cloud based software to the utility industry. Mr. McLaughlin holds a B.S. from the U.S. Military Academy at West Point and a J.D. from Seattle University School of Law. Mr. McLaughlin was selected to serve on our board of directors because of the perspective and experience he brings as our Chief Executive Officer and his extensive background in the technology industry.

*Stanley J. Meresman* has served as a member of our board of directors since September 2014. Prior to that, Mr. Meresman was a Venture Partner with Technology Crossover Ventures, a private equity firm, from January 2004 to December 2004, and served as General Partner and Chief Operating Officer from November 2001 to December 2003. During the four years prior to joining Technology Crossover Ventures, Mr. Meresman was a private investor, board member and advisor to several technology companies. From May 1989 to May 1997, Mr. Meresman was the Senior Vice President and Chief Financial Officer of Silicon Graphics, Inc., a manufacturer of high-performance computing solutions. Prior to Silicon Graphics, he was Vice President of Finance and Administration and Chief Financial Officer of Cypress Semiconductor, a semiconductor company. Mr. Meresman currently serves on the board of directors of Snap, Inc., a camera and social media company, and several private companies. He previously served on the board of directors of LinkedIn Corporation, Zynga Inc., Meru Networks, Riverbed Technology, Inc. and Polycom, Inc. Mr. Meresman holds an M.B.A. from the Stanford Graduate School of Business and a B.S. in Industrial Engineering and Operations Research from the University of California, Berkeley. Mr. Meresman was selected to serve on our board of directors due, in part, to his background as chair of the audit committee of other public companies and his financial and accounting expertise from his prior extensive experience as Chief Financial Officer of two public NYSE-listed companies.

*Sridhar Ramaswamy* has served as a member of our board of directors since August 2017. Mr. Ramaswamy currently serves as Senior Vice President Ads & Commerce at Google, Inc., a multinational technology company that specializes in internet-related services and products, a position he has held since March 2013. From 2003 to March 2013, Mr. Ramaswamy served in various leadership roles in Google's engineering group, including as Senior Vice President Engineering. Prior to joining Google, Mr. Ramaswamy served in engineering and other technical roles at E.piphany Inc., Bell Laboratories, Inc., and Telcordia Technologies, Inc. Mr. Ramaswamy holds a B.S. in Computer Science from the India Institute of Technology, Madras India and a M.S. and PhD in Computer Science from Brown University. Mr. Ramaswamy was selected to serve on our board of directors due, in part, to the depth of his technical engineering background and his extensive cloud and infrastructure expertise.

*Nir Zuk* is one of our founders and has served as our Chief Technology Officer and as a member of our board of directors since March 2005. From April 2004 to March 2005, Mr. Zuk was Chief Security Technologist at Juniper Networks, Inc., a supplier of network infrastructure products and services. From September 2002 until its acquisition by Juniper in April 2004, Mr. Zuk was Chief Technology Officer at NetScreen Technologies, Inc., a provider of ASIC-based Internet security systems. In December 1999, Mr. Zuk co-founded OneSecure, Inc., a provider of prevention and detection appliances, and was Chief Technical Officer until its acquisition by NetScreen in September 2002. From 1994 to 1999, Mr. Zuk served in several technical roles, including Principal Engineer at Check Point Software Technologies Ltd., an enterprise software security company. Mr. Zuk attended

Tel Aviv University where he studied Mathematics. Mr. Zuk was selected to serve on our board of directors because of the perspective and experience he brings as one of our founders and as one of our largest stockholders, as well as his extensive experience with network security companies.

### **Director Independence**

Our common stock is listed on the NYSE. Under the listing standards of the NYSE, independent directors must comprise a majority of a listed company's board of directors. In addition, the listing standards of the NYSE require that, subject to specified exceptions, each member of a listed company's audit, compensation, and nominating and corporate governance committees be independent. Under the listing standards of the NYSE, a director will only qualify as an "independent director" if, in the opinion of that listed company's board of directors, that director does not have a material relationship with the company, either directly or indirectly, that would interfere with the exercise of independent judgment in carrying out the responsibilities of a director.

Audit committee members must also satisfy the additional independence criteria set forth in Rule 10A-3 under the Securities Exchange Act of 1934, as amended (the "Exchange Act") and the listing standards of the NYSE. In order to be considered independent for purposes of Rule 10A-3, a member of a listed company's audit committee may not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee: (1) accept, directly or indirectly, any consulting, advisory, or other compensatory fee from the listed company or any of its subsidiaries; or (2) be an affiliated person of the listed company or any of its subsidiaries.

Compensation committee members must also satisfy the additional independence criteria set forth in Rule 10C-1 under the Exchange Act and the listing standards of the NYSE. In order for a member of a listed company's compensation committee to be considered independent for purposes of the listing standards of the NYSE, the listed company's board of directors must consider all factors specifically relevant to determining whether a director has a relationship to the listed company that is material to that director's ability to be independent from management in connection with the duties of a compensation committee member, including, but not limited to: (1) the source of compensation of such director, including any consulting, advisory, or other compensatory fee paid by the listed company to such director; and (2) whether such director is affiliated with the listed company, a subsidiary of the listed company, or an affiliate of a subsidiary of the listed company.

Our board of directors has undertaken a review of the independence of each of our directors. Based on information provided by each director concerning his or her background, employment, and affiliations, our board of directors has determined that Ms. McCarthy and each of Messrs. Calderoni, Chandna, Donovan, Eschenbach, Goetz, Meresman, Ramaswamy and Warmenhoven do not have a material relationship with the company, either directly or indirectly, that would interfere with the exercise of independent judgment in carrying out the responsibilities of a director and that each of these directors is "independent" as that term is defined under the applicable rules and regulations of the SEC and the listing standards of the NYSE. In making these determinations, our board of directors considered the current and prior relationships that each non-employee director has with our company and all other facts and circumstances our board of directors deemed relevant in determining their independence, including the beneficial ownership of our common stock by each non-employee director and the transactions involving them described in the section titled "Certain Relationships and Related Party Transactions."

Since the beginning of our last fiscal year through October 15, 2017, both directly and through our channel partners, we have sold an aggregate of approximately \$58.8 million and \$0.5 million of products and services to AT&T Inc. ("AT&T") and Anaplan, Inc. ("Anaplan") respectively, in arm's length transactions. In addition, since the beginning of our last fiscal year through October 15, 2017, we have purchased an aggregate of approximately \$0.2 million, \$0.7 million and \$4.5 million of AT&T, Anaplan and Google, Inc. products and services, respectively, in arm's length transactions.

We entered into these commercial dealings in the ordinary course of our business. In making the determinations as to which members of our board of directors are independent, our board of directors considered the fact that Mr. Donovan, one of our directors, is an executive officer of AT&T, that Mr. Calderoni, one of our directors, is an executive officer at Anaplan, and that Mr. Ramaswamy, one of our directors, is an executive at Google. In reviewing these relationships, our board of directors determined these relationships do not impede the ability of Mr. Donovan, Mr. Calderoni or Mr. Ramaswamy to act independently on our behalf and on behalf of our stockholders.

Additionally, none of Messrs. Donovan, Calderoni or Ramaswamy take part in the discussion of transactions with AT&T, Anaplan, or Google, respectively, when such transactions are reviewed by our board of directors. Additionally, AT&T expects its 2017 capital expenditures to be in the \$22 billion range. AT&T's purchases of our products and services, which totaled \$58.8 million, are not material to either us or AT&T. All transactions with AT&T, Anaplan and Google are subject to our rigorous related party transactions review process and policy.

### **Leadership Structure**

Mr. McLaughlin currently serves as both Chairman of our board of directors and as our Chief Executive Officer. Our board of directors believes that the current board leadership structure, coupled with a strong emphasis on board independence, provides effective independent oversight of management while allowing our board of directors and management to benefit from Mr. McLaughlin's leadership and years of experience as an executive in the technology industry. Serving on our board of directors and as Chief Executive Officer since August 2011, Mr. McLaughlin is best positioned to identify strategic priorities, lead critical discussion and execute our strategy and business plans. Mr. McLaughlin possesses detailed in-depth knowledge of the issues, opportunities, and challenges facing us. Independent directors and management sometimes have different perspectives and roles in strategy development. Our independent directors bring experience, oversight and expertise from outside of our company, while our Chief Executive Officer brings company specific experience and expertise. Our board of directors believes that Mr. McLaughlin's combined role enables strong leadership, creates clear accountability, and enhances our ability to communicate our message and strategy clearly and consistently to stockholders.

### **Lead Independent Director**

Our corporate governance guidelines provide that one of our independent directors should serve as a Lead Independent Director at any time when our Chief Executive Officer serves as the Chairman of our board of directors or if our Chairman is not otherwise independent. Because our Chief Executive Officer, Mr. McLaughlin, is our Chairman, our board of directors has appointed Mr. Warmenhoven to serve as our Lead Independent Director. As our Lead Independent Director, Mr. Warmenhoven presides over periodic meetings of our independent directors, serves as a liaison between our Chairman and the independent directors and performs such additional duties as our board of directors may otherwise determine and delegate.

### **Board Effectiveness; Director Assessment; Board Education**

It is important that our board of directors and its committees are performing effectively and in the best interest of Palo Alto Networks and its stockholders. Our board of directors performs an annual self-assessment, overseen by the nominating and corporate governance committee, to evaluate its effectiveness in fulfilling its obligations. Directors are sent questions by our outside legal counsel covering board of directors, committee, self and peer performance. Our outside legal counsel then interviews each director to obtain his or her assessment of the effectiveness of our board of directors and committees, as well as director performance and board of directors' dynamics, summarizes these individual assessments for discussion with the board of directors and committees, and leads a discussion with the nominating and corporate governance committee and the board of directors. The board of directors then takes such further action as it deems appropriate. In addition, we encourage directors to participate in continuing education programs focused on our business and industry, committee roles and responsibilities, and legal and ethical responsibilities of directors.

## **Board Meetings and Committees**

During our fiscal year ended July 31, 2017, the board of directors held eight meetings (including regularly scheduled and special meetings), and no director attended fewer than 75% of the total number of meetings of the board of directors and the committees of which he was a member.

Although we do not have a formal policy regarding attendance by members of our board of directors at annual meetings of stockholders, we encourage, but do not require, our directors to attend. Eight of our ten directors at the time attended our 2016 Annual Meeting of Stockholders, either telephonically or in person.

Our board of directors has an audit committee, a compensation committee, and a nominating and corporate governance committee, each of which has the composition and responsibilities described below. Directors serve on these committees until their resignation or until otherwise determined by our board of directors. All of the directors on the standing committees of our board of directors are independent, and each of these committees is led by a committee chairperson.

### ***Audit Committee***

Our audit committee consists of Ms. McCarthy and Messrs. Calderoni, Donovan and Meresman, with Mr. Meresman serving as the chair.

The composition of our audit committee meets the requirements for independence for audit committee members under the listing standards of the NYSE and the rules and regulations of the SEC. Each member of our audit committee also meets the financial literacy and sophistication requirements of the listing standards of the NYSE. In addition, our board of directors has determined that each of Ms. McCarthy and Messrs. Calderoni and Meresman are “audit committee financial experts” within the meaning of the rules and regulations of the SEC. Our audit committee is responsible for, among other things:

- selecting and hiring our independent registered public accounting firm;
- evaluating the performance and independence of our independent registered public accounting firm;
- approving the audit and pre-approving any non-audit services to be performed by our independent registered public accounting firm;
- reviewing our financial statements and related disclosures and reviewing our critical accounting policies and practices;
- reviewing the adequacy and effectiveness of our internal control policies and procedures and our disclosure controls and procedures;
- reviewing and participating in the selection of our internal auditor and periodically reviewing the activities and reports of the internal audit function and any issues encountered in the course of the internal audit function’s work;
- overseeing procedures for the treatment of complaints on accounting, internal accounting controls, or audit matters;
- reviewing and discussing with management and the independent registered public accounting firm the results of our annual audit, our quarterly financial statements, and our publicly filed reports;
- reviewing and approving or ratifying any proposed related person transactions; and
- preparing the audit committee report that the SEC requires in our annual proxy statement.

Our audit committee operates under a written charter that was adopted by our board of directors and satisfies the applicable rules and regulations of the SEC and the listing standards of the NYSE. A copy of the charter of our audit committee is available on our website at <http://investors.paloaltonetworks.com/>. During our fiscal year ended July 31, 2017, our audit committee held seven meetings.



### ***Compensation Committee***

Our compensation committee consists of Messrs. Chandna, Eschenbach, Goetz and Warmenhoven, with Mr. Chandna serving as the chair. The composition of our compensation committee meets the requirements for independence for compensation committee members under the listing standards of the NYSE and the rules and regulations of the SEC. Each member of our compensation committee is also a “non-employee director,” as defined pursuant to Rule 16b-3 promulgated under the Exchange Act, and an “outside director,” as defined pursuant to Section 162(m) of the Internal Revenue Code (the “Code”). The purpose of our compensation committee is to discharge the responsibilities of our board of directors relating to compensation of our executive officers. Our compensation committee is responsible for, among other things:

- reviewing and approving our Chief Executive Officer’s and other executive officers’ annual base salaries, incentive compensation arrangements, including the specific goals and amounts, equity compensation, employment agreements, severance arrangements and change in control agreements, and any other benefits, compensation or arrangements;
- administering our equity compensation plans;
- overseeing our overall compensation philosophy and compensation plans; and
- preparing the compensation committee report that the SEC requires to accompany the Compensation Discussion and Analysis contained in our annual proxy statement.

Our compensation committee operates under a written charter that was adopted by our board of directors and satisfies the applicable rules and regulations of the SEC and the listing standards of the NYSE. A copy of the charter of our compensation committee is available on our website at <http://investors.paloaltonetworks.com>. During our fiscal year ended July 31, 2017, our compensation committee held four meetings.

### ***Nominating and Corporate Governance Committee***

Our nominating and corporate governance committee consists of Messrs. Chandna, Eschenbach, Goetz, Ramaswamy and Warmenhoven, with Mr. Warmenhoven serving as the chair. The composition of our nominating and corporate governance committee meets the requirements for independence under the listing standards of the NYSE and the rules and regulations of the SEC. Our nominating and corporate governance committee is responsible for, among other things:

- evaluating and making recommendations regarding the composition, organization, and governance of our board of directors and its committees;
- evaluating and making recommendations regarding the creation of additional committees or the change in mandate or dissolution of committees;
- reviewing and making recommendations with regard to our corporate governance guidelines and compliance with laws and regulations;
- reviewing and approving conflicts of interest of our directors and corporate officers, other than related person transactions reviewed by our audit committee; and
- oversees our annual board of director and committee self-assessment process.

Our nominating and corporate governance committee operates under a written charter that was adopted by our board of directors and satisfies the applicable listing standards of the NYSE. A copy of the charter of our nominating and corporate governance committee is available on our website at <http://investors.paloaltonetworks.com/>. During our fiscal year ended July 31, 2017, our nominating and corporate governance committee held four meetings.

## **Compensation Committee Interlocks and Insider Participation**

None of the members of our compensation committee is or has been an officer or employee of our company. None of our executive officers currently serves, or in the past year has served, as a member of the board of directors or compensation committee (or other board committee performing equivalent functions) of any entity that has one or more of its executive officers serving on our board of directors or compensation committee.

## **Considerations in Evaluating Director Nominees**

Our nominating and corporate governance committee uses a variety of methods for identifying and evaluating director nominees. In its evaluation of director candidates, our nominating and corporate governance committee will consider the current size and composition of our board of directors and the needs of our board of directors and the respective committees of our board of directors. Some of the qualifications that our nominating and corporate governance committee considers include, without limitation, issues of character, integrity, judgment, diversity (including gender and race), experience of particular relevance to us and the board of directors, independence, age, area of expertise, length of service, potential conflicts of interest and other commitments. These factors may be weighted differently depending on the individual being considered or the needs of the board of directors at the time.

Nominees must also have the ability to offer advice and guidance to our Chief Executive Officer based on past experience in positions with a high degree of responsibility and be leaders in the companies or institutions with which they are affiliated. Director candidates must have sufficient time available in the judgment of our nominating and corporate governance committee to perform all board of director and committee responsibilities. Members of our board of directors are expected to prepare for, attend, and actively participate in all board of director and applicable committee meetings. Given the significant time commitment that board membership requires, our board of directors generally believes that no director should be a member of more than three public company boards. Other than the foregoing, there are no stated minimum criteria for director nominees, although our nominating and corporate governance committee may also consider such other factors as it may deem, from time to time, are in our and our stockholders' best interests. Our nominating and corporate governance committee will also seek appropriate input from our Chief Executive Officer from time to time in assessing the needs of our board of directors for relevant background, experience, diversity and skills of its members.

Our board of directors should be a diverse body, with varying perspectives and experiences. Our nominating and corporate governance committee considers diversity (whether based on broader principles such as diversity of perspective, experiences, and expertise, as well as factors commonly associated with diversity such as gender, race or national origin) in connection with its evaluation of director candidates, including the evaluation and determination of whether to re-nominate incumbent directors. Our nominating and corporate governance committee also considers these and other factors as it oversees the annual board of director and committee evaluations. The nominating and corporate governance committee is committed to seeking out qualified and diverse director candidates, including women and individuals from minority groups, to include in the pool from which director candidates are chosen. Any search firm retained by our nominating and corporate governance committee to find director candidates would be instructed to take into account all of the considerations used by our nominating and corporate governance committee including diversity. After completing its review and evaluation of director candidates, our nominating and corporate governance committee recommends to our full board of directors the director nominees for selection.

## **Stockholder Recommendations for Nominations to the Board of Directors**

Our nominating and corporate governance committee will consider candidates for director recommended by stockholders holding at least one percent (1%) of the fully diluted capitalization of our company continuously for at least twelve (12) months prior to the date of the submission of the recommendation, so long as such recommendations comply with our certificate of incorporation and bylaws and applicable laws, rules and

regulations, including those promulgated by the SEC. The nominating and corporate governance committee will evaluate such recommendations in accordance with its charter, our amended and restated bylaws, our policies and procedures for director candidates, as well as the regular director nominee criteria described above. This process is designed to ensure that our board of directors includes members with diverse backgrounds, skills and experience, including appropriate financial and other expertise relevant to our business. Eligible stockholders wishing to recommend a candidate for nomination should contact our Corporate Secretary in writing. Such recommendations must include information about the candidate, a statement of support by the recommending stockholder, evidence of the recommending stockholder's ownership of our common stock and a signed letter from the candidate confirming willingness to serve on our board of directors. Our nominating and corporate governance committee has discretion to decide which individuals to recommend for nomination as directors.

Under our bylaws, stockholders may also nominate persons for our board of directors. Any nomination must comply with the requirements set forth in our bylaws and recommendations should be sent in writing to our Corporate Secretary at Palo Alto Networks, Inc., 3000 Tannery Way, Santa Clara, California 95054.

### **Communications with the Board of Directors**

Interested parties wishing to communicate with our board of directors or with an individual member or members of our board of directors may do so by writing to the board of directors or to the particular member or members of our board of directors, and mailing the correspondence to our General Counsel or our Legal Department, at Palo Alto Networks, Inc., 3000 Tannery Way, Santa Clara, California 95054. Our General Counsel or our Legal Department, in consultation with appropriate members of our board of directors, as necessary, will review all incoming communications and, if appropriate, all such communications will be forwarded to the appropriate member or members of our board of directors, or if none is specified, to the Chairman of our board of directors.

### **Corporate Governance Guidelines and Code of Business Conduct and Ethics**

Our board of directors has adopted Corporate Governance Guidelines. These guidelines address items such as the qualifications and responsibilities of our directors and director candidates and corporate governance policies and standards applicable to us in general. In addition, our board of directors has adopted a Code of Business Conduct and Ethics that applies to all of our employees, officers and directors, including our Chief Executive Officer, Chief Financial Officer, and other executive and senior financial officers. The full text of our Corporate Governance Guidelines and our Code of Business Conduct and Ethics is posted on the Investor Information portion of our website at <http://investors.paloaltonetworks.com/>. We will post amendments to our Code of Business Conduct and Ethics or waivers of our Code of Business Conduct and Ethics for directors and executive officers on the same website.

### **Risk Management**

Risk is inherent with every business, and we face a number of risks, including strategic, financial, business and operational, legal and compliance, and reputational. We have designed and implemented processes to manage risk in our operations. Management is responsible for the day-to-day management of risks the company faces, while our board of directors, as a whole and assisted by its committees, has responsibility for the oversight of risk management. In its risk oversight role, our board of directors has the responsibility to satisfy itself that the risk management processes designed and implemented by management are appropriate and functioning as designed.

Our board of directors believes that open communication between management and our board of directors is essential for effective risk management and oversight. Our board of directors meets with our Chief Executive Officer and other members of the senior management team at quarterly meetings of our board of directors, where, among other topics, they discuss strategy and risks facing the company, as well as at such other times as they deem appropriate.

While our board of directors is ultimately responsible for risk oversight, our board committees assist our board of directors in fulfilling its oversight responsibilities in certain areas of risk. Our audit committee assists our board of directors in fulfilling its oversight responsibilities with respect to risk management in the areas of internal control over financial reporting and disclosure controls and procedures, legal and regulatory compliance, and discusses with management and the independent auditor guidelines and policies with respect to risk assessment and risk management. Our audit committee also reviews our major financial risk exposures and the steps management has taken to monitor and control these exposures. Our audit committee also monitors certain key risks on a regular basis throughout the fiscal year, such as risk associated with internal control over financial reporting and liquidity risk. Our nominating and corporate governance committee assists our board of directors in fulfilling its oversight responsibilities with respect to the management of risk associated with board organization, membership and structure, and corporate governance. Our compensation committee assesses risks created by the incentives inherent in our compensation programs and policies. Finally, our board of directors reviews strategic and operational risk in the context of reports from the management team, receives reports on all significant committee activities at each regular meeting, and evaluates the risks inherent in significant transactions.

### **Succession Planning**

Our board of directors and management team recognize the importance of continually developing our talented employee base. Accordingly, our management team conducts an annual talent review of the current senior leadership positions. In addition, our CEO annually reviews a succession plan for the CEO position, using formal criteria to evaluate potential successors and also interim candidates in the event of an emergency situation. In conducting its evaluation, our board of directors considers organizational needs, competitive challenges, leadership/management potential and development, and emergency situations.

### **Director Stock Ownership Guidelines**

Our board of directors believes that our directors and executive officers should hold a meaningful financial stake in the company in order to further align their interests with those of our stockholders and therefore adopted stock ownership guidelines in fiscal 2017. Under the guidelines, each non-employee director must own the lesser of (i) company stock with a value of three times the annual cash retainer for board service or (ii) 6,875 shares. Our non-employee directors are required to achieve ownership of our common stock within five years of the later of August 26, 2016 or such director's appointment or election date as applicable.

See the section titled "Discussion of our Fiscal 2017 Executive Compensation Program—Other Compensation Policies—Stock Ownership and Compensation Recovery Policies" for additional details on our executive ownership guidelines.

### **Director Compensation**

In fiscal 2013, our nominating and corporate governance committee approved a policy for the compensation of the non-employee members of our board of directors (the "Director Compensation Policy") to attract, retain, and reward these individuals and align their financial interests with those of our stockholders. Only non-employee directors who are not affiliated with investment funds that hold shares of our common stock are eligible for compensation under the Director Compensation Policy. The Director Compensation Policy was amended in September 2014, effective for fiscal 2015. There is no cash compensation paid under the Director Compensation Policy.

*Initial Award.* Under the Director Compensation Policy and prior to its recent amendment, when an eligible director initially joined our board of directors, the eligible director received an initial award of restricted stock units having a value between \$750,000 to \$1 million (as determined based on the average closing price of our common stock on the NYSE during the 30 calendar days prior to the date of grant). The value of this initial award has been subsequently increased to \$1 million effective the beginning of fiscal 2015. This initial award will vest as to one third of the shares covered by the restricted stock unit award on the first anniversary of the

date the eligible director joined our board of directors, and the remaining shares will vest quarterly over the following two years, subject to the director's continued service as of each such date.

*Annual Award.* Under the Director Compensation Policy and prior to its recent amendment, at each annual meeting of stockholders, each eligible director received an annual restricted stock unit award having a value equal to \$200,000 (as determined based on the average closing price of our common stock on the NYSE during the 30 calendar days prior to the date of grant). The value of the annual award has been subsequently increased to \$300,000 effective the beginning of fiscal 2015. In addition, at each annual meeting of stockholders, our Lead Independent Director will receive an additional annual restricted stock unit award having a value equal to \$50,000 (as determined based on the average closing price of our common stock on the NYSE during the 30 calendar days prior to the date of grant). All annual awards, including the annual awards to the lead independent director, will vest quarterly over a period of one year, subject to the director's continued service as of each such date.

*Committee Awards.* At each annual meeting of stockholders, the chairpersons and members of the three standing committees of our board of directors will receive additional annual restricted stock unit awards for committee service having the following values (as determined based on the average closing price of our common stock on the NYSE during the 30 calendar days prior to the date of grant):

<u>Board Committee</u>	<u>Chairperson Retainer (\$)</u>	<u>Member Retainer (\$)</u>
Audit Committee . . . . .	35,000	20,000
Compensation Committee . . . . .	25,000	15,000
Nominating and Corporate Governance Committee . .	15,000	10,000

Any eligible director who serves as chairperson of a committee is not entitled to a member retainer for the same committee. The committee awards will vest quarterly over a period of one year, subject to the director's continued service as of each such date.

***Fiscal 2017 Director Compensation Table***

The following table presents summary information regarding the compensation paid to our non-employee directors for our fiscal year ended July 31, 2017.

<u>Director</u>	<u>Stock Awards (\$ (1))</u>	<u>Total(\$)</u>
Frank Calderoni (2) . . . . .	289,629	289,629
Asheem Chandna (3) . . . . .	303,215	303,215
John M. Donovan (4) . . . . .	289,629	289,629
Carl Eschenbach (5) . . . . .	294,071	294,071
James J. Goetz (6) . . . . .	—	—
Mary Pat McCarthy (7) . . . . .	962,539	962,539
Stanley J. Meresman (8) . . . . .	303,215	303,215
Daniel J. Warmenhoven (9) . . . . .	343,714	343,714
Sridhar Ramaswamy (10) . . . . .	—	—

(1) The amounts reported in this column represent the aggregate grant date fair value of these restricted stock units ("RSUs") as computed in accordance with Financial Accounting Standards Board Accounting Standards Codification Topic 718, Compensation—Stock Compensation, or ASC Topic 718. The assumptions used in the valuation of these awards are set forth in the notes to our consolidated financial statements, which are included in our Annual Report on Form 10-K for our fiscal year ended July 31, 2017, filed with the SEC on September 7, 2017. These amounts do not necessarily correspond to the actual value that may be recognized by the director upon the vesting of such awards.

- (2) As of July 31, 2017, Mr. Calderoni held 5,197 RSUs.
- (3) As of July 31, 2017, Mr. Chandna held 1,160 RSUs.
- (4) As of July 31, 2017, Mr. Donovan held 1,108 RSUs.
- (5) As of July 31, 2017, Mr. Eschenbach held 1,125 RSUs.
- (6) Mr. Goetz receives no compensation under the Director Compensation Policy.
- (7) Effective as of October 20, 2016, Ms. McCarthy was elected to our board of directors. The value in the table above represents the initial stock award she received on October 20, 2016. Given the date of Ms. McCarthy's appointment to our board of directors, and pursuant to the terms of her offer letter, she will first be eligible to receive equity grants equal to the value of the annual board and audit committee stock awards set forth in our Director Compensation Policy at the Annual Meeting. As of July 31, 2017, Ms. McCarthy held 6,480 RSUs.
- (8) As of July 31, 2017, Mr. Meresman held 2,103 RSUs.
- (9) As of July 31, 2017, Mr. Warmenhoven held 1,315 RSUs.
- (10) Effective as of August 29, 2017, Mr. Ramaswamy was elected to our board of directors. Accordingly, he did not earn any compensation in fiscal 2017.

**PROPOSAL NO. 2  
RATIFICATION OF APPOINTMENT OF  
INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Our audit committee has appointed Ernst & Young LLP (“EY”), independent registered public accountants, to audit our financial statements for our fiscal year ending July 31, 2018. During our fiscal year ended July 31, 2017, EY served as our independent registered public accounting firm.

Notwithstanding the selection of EY and even if our stockholders ratify the selection, our audit committee, in its discretion, may appoint another independent registered public accounting firm at any time during our fiscal year if our audit committee believes that such a change would be in the best interests of Palo Alto Networks and its stockholders. At the Annual Meeting, our stockholders are being asked to ratify the appointment of EY as our independent registered public accounting firm for our fiscal year ending July 31, 2018. Our audit committee is submitting the selection of EY to our stockholders because we value our stockholders views on our independent registered public accounting firm and as a matter of good corporate governance. Representatives of EY will be present at the Annual Meeting, and they will have an opportunity to make statements and will be available to respond to appropriate questions from our stockholders.

If our stockholders do not ratify the appointment of EY, our board of directors may reconsider the appointment.

**Fees Paid to the Independent Registered Public Accounting Firm**

The following table presents fees for professional audit services and other services rendered to our company by EY for our fiscal years ended July 31, 2016 and 2017.

	<u>2016</u>	<u>2017</u>
Audit Fees (1) . . . . .	\$3,039,554	\$3,654,504
Audit-Related Fees (2) . . . . .	475,278	191,985
Tax Fees (3) . . . . .	341,322	780,599
All Other Fees . . . . .	0	0
	<u>\$3,856,154</u>	<u>\$4,627,088</u>

- (1) Audit fees consist of professional services rendered in connection with the audit of our annual consolidated financial statements, including audited financial statements presented in our Annual Report on Form 10-K, and review of our quarterly consolidated financial statements presented in our Quarterly Reports on Form 10-Q. These fees also include professional services provided for new and existing statutory audits of subsidiaries or affiliates of the Company.
- (2) Audit-Related fees consist of fees for professional services for assurance and related services that are reasonably related to the performance of the audit or review of our consolidated financial statements and are not reported under “Audit Fees.” These services include accounting consultations, services provided in connection with regulatory filings, technical accounting guidance and other attestation services.
- (3) Tax Fees consist of fees for professional services for tax compliance and tax planning. These services include assistance regarding federal, state and international tax compliance.

**Auditor Independence**

In our fiscal year ended July 31, 2017, there were no other professional services provided by EY that would have required our audit committee to consider their compatibility with maintaining the independence of EY.

## **Audit Committee Policy on Pre-Approval of Audit and Permissible Non-Audit Services of Independent Registered Public Accounting Firm**

Consistent with requirements of the SEC and the Public Company Oversight Board (the “PCAOB”) regarding auditor independence, our audit committee is responsible for the appointment, compensation and oversight of the work of our independent registered public accounting firm. In recognition of this responsibility, our audit committee has established a policy for the pre-approval of all audit and permissible non-audit services provided by our independent registered public accounting firm. These services may include audit services, audit-related services, tax services and other services.

Before engagement of the independent registered public accounting firm for the next year’s audit, the independent registered public accounting firm submits a detailed description of services expected to be rendered during that year for each of the following categories of services to our audit committee for approval:

- *Audit services.* Audit services include work performed for the audit of our financial statements and the review of financial statements included in our quarterly reports, as well as work that is normally provided by the independent registered public accounting firm in connection with statutory and regulatory filings.
- *Audit related services.* Audit related services are for assurance and related services that are reasonably related to the performance of the audit or review of our financial statements and are not covered above under “audit services.”
- *Tax services.* Tax services include all services performed by the independent registered public accounting firm’s tax personnel for tax compliance, tax advice and tax planning.
- *Other services.* Other services are those services not described in the other categories.

Our audit committee pre-approves particular services or categories of services on a case-by-case basis. The fees are budgeted, and our audit committee requires our independent registered public accounting firm and management to report actual fees versus budgeted fees periodically throughout the year by category of service. During the year, circumstances may arise when it may become necessary to engage the independent registered public accounting firm for additional services not contemplated in the original pre-approval. In those instances, the services must be pre-approved by our audit committee before our independent registered public accounting firm is engaged. Any proposed services exceeding these levels or amounts require specific pre-approval by our audit committee. All fees paid to EY for our fiscal year ended July 31, 2017, were pre-approved by our audit committee.

**THE BOARD OF DIRECTORS RECOMMENDS A VOTE “FOR” THE RATIFICATION  
OF THE APPOINTMENT OF ERNST & YOUNG LLP.**



## REPORT OF THE AUDIT COMMITTEE

The audit committee consists of Ms. McCarthy and Messrs. Calderoni, Donovan and Meresman, with Mr. Meresman serving as the chair. Each member of the committee is an independent director as required by the listing standards of the NYSE and rules and regulations of the SEC. The audit committee operates under a written charter approved by the board of directors, which is available on the Investor Information portion of our web site at [www.paloaltonetworks.com](http://www.paloaltonetworks.com). The composition of the audit committee, the attributes of its members and the responsibilities of the audit committee, as reflected in its charter, are intended to be in accordance with applicable requirements for corporate audit committees. The audit committee reviews and assesses the adequacy of its charter and the audit committee's performance on an annual basis.

The audit committee assists our board of directors in the board's oversight and monitoring of:

- our accounting and financial reporting processes and internal controls as well as the audit and integrity of our financial statements;
- the qualifications, independence and performance of our independent registered public accounting firm;
- the performance of our internal audit function;
- our compliance with applicable law; and
- risk assessment and risk management pertaining to financial, accounting and tax matters of the company.

With respect to the company's financial reporting process, the management of the company is responsible for (1) establishing and maintaining internal controls and (2) preparing the company's consolidated financial statements. Our independent registered public accounting firm, Ernst & Young LLP ("EY"), is responsible for auditing these financial statements. It is the responsibility of the audit committee to oversee these activities. It is not the responsibility of the audit committee to prepare or certify our financial statements or guarantee the audits or reports of the independent auditors. These are the fundamental responsibilities of management and our independent registered public accounting firm.

The audit committee is responsible for the appointment, compensation, retention, and oversight of the work performed by EY. In fulfilling its oversight responsibility, the audit committee carefully reviews the policies and procedures for the engagement of the independent registered public accounting firm, including the scope of the audit, audit fees, auditor independence matters, performance of the independent auditors, and the extent to which the independent registered public accounting firm may be retained to perform non-audit services.

In the performance of its oversight function, the audit committee has:

- reviewed and discussed the audited financial statements with management and EY;
- discussed with EY the matters required to be discussed by the statement on Auditing Standards No. 16, as amended (AICPA, Professional Standards, Vol. 1. AU section 380), and as adopted by the Public Company Accounting Oversight Board in Rule 3200T; and
- received the written disclosures and the letter from EY required by applicable requirements of the Public Company Accounting Oversight Board regarding the independent accountant's communications with the audit committee concerning independence, and has discussed with EY its independence.

Based on the audit committee's review and discussions with management and EY, the audit committee recommended to the board of directors that the audited financial statements be included in the Annual Report on Form 10-K for the fiscal year ended July 31, 2017, for filing with the Securities and Exchange Commission.

Respectfully submitted by the members of the audit committee of the board of directors:

Stanley J. Meresman (Chair)

Mary Pat McCarthy

Frank Calderoni

John M. Donovan

**PROPOSAL NO. 3**  
**ADVISORY VOTE ON THE COMPENSATION OF OUR NAMED EXECUTIVE OFFICERS**

In accordance with the rules and regulations of the SEC, pursuant to Section 14A of the Exchange Act, we are providing our stockholders with the opportunity to vote to approve, on an advisory or non-binding basis, the compensation of our named executive officers as disclosed in accordance with the rules and regulations of the SEC in the “Executive Compensation” section of this proxy statement. This proposal, commonly known as a “say-on-pay” proposal, gives our stockholders the opportunity to express their views on our named executive officers’ compensation as a whole. This vote is not intended to address any specific item of compensation or any specific named executive officer, but rather the overall compensation of all of our named executive officers and the philosophy, policies and practices described in this proxy statement.

The say-on-pay vote is advisory, and therefore is not binding on us, our compensation committee or our board of directors. The say-on-pay vote will, however, provide information to us regarding investor sentiment about our executive compensation philosophy, policies and practices, which our compensation committee will be able to consider when determining executive compensation for the remainder of the current fiscal year and beyond. Our board of directors and our compensation committee value the opinions of our stockholders and to the extent there is any significant vote against the compensation of our named executive officers as disclosed in this proxy statement, we will endeavor to communicate with stockholders to better understand the concerns that influenced the vote and consider our stockholders’ concerns and our compensation committee will evaluate whether any actions are necessary to address those concerns.

We believe that the information we have provided in the section titled “Executive Compensation,” and in particular the information discussed in the section titled “Executive Compensation—Compensation Discussion and Analysis,” demonstrates that our executive compensation program has been designed appropriately and is working to ensure management’s interests are aligned with our stockholders’ interests to support long-term value creation. Accordingly, we ask our stockholders to vote “FOR” the following resolution at the Annual Meeting:

“RESOLVED, that Palo Alto Networks, Inc.’s stockholders approve, on an advisory basis, the compensation of the named executive officers, as disclosed in Palo Alto Networks, Inc.’s proxy statement for the 2017 Annual Meeting of Stockholders pursuant to the compensation disclosure rules and regulations of the SEC, including the compensation discussion and analysis, the compensation tables and narrative discussion, and other related disclosure.”

**THE BOARD OF DIRECTORS RECOMMENDS A VOTE “FOR” THE APPROVAL, ON AN  
ADVISORY BASIS, OF THE COMPENSATION OF OUR NAMED EXECUTIVE OFFICERS.**

**PROPOSAL NO. 4**  
**APPROVAL OF THE EXECUTIVE INCENTIVE PLAN**

In August 2017, our compensation committee adopted the Executive Incentive Plan (the “Incentive Plan”), subject to approval from our stockholders at the Annual Meeting. We are asking stockholders to approve the Incentive Plan, so that we would have the ability to grant awards that may be deductible in full for federal income tax purposes the compensation recognized by our executive officers in connection with performance-based cash bonuses and equity awards granted under the Incentive Plan.

Section 162(m) of the Internal Revenue Code (“Section 162(m)”) generally denies a corporate tax deduction for annual compensation exceeding \$1 million paid to the chief executive officer and other “covered employees” as determined under Section 162(m) and applicable guidance. However, certain types of compensation, including “performance-based compensation” within the meaning of Section 162(m), are excluded from this deductibility limit. For performance-based cash incentives and equity awards granted under the Incentive Plan to qualify as such “performance-based compensation,” the material terms of the Incentive Plan must be approved by our stockholders.

The Incentive Plan will not become effective if it is not approved by our stockholders, but if that happens, we may pay bonuses or grant equity awards outside of the Incentive Plan, which may not be fully deductible by us for federal income tax purposes.

**Summary of the Incentive Plan**

The following paragraphs provide a summary of the principal features of the Incentive Plan and its operation. However, this summary is not a complete description of all of the provisions of the Incentive Plan and is qualified in its entirety by the specific language of the Incentive Plan. A copy of the Incentive Plan is provided as Appendix A to this Proxy Statement.

***Purposes of the Incentive Plan***

The purpose of the Incentive Plan is to motivate and reward eligible service providers of our company for their service by providing incentive compensation in the form of cash bonuses and equity compensation. The cash bonuses and equity awards granted under the Incentive Plan are intended to be fully deductible under Section 162(m), but we cannot guarantee they will qualify for the performance-based exemption under Section 162(m). The Incentive Plan includes a component setting forth the terms for performance-based cash awards (the “cash component”) and a component setting forth the terms for performance-based equity awards (the “equity component”).

***Cash Component***

***Eligibility***

Actual awards under the cash component may only be issued to our employees or any affiliate of our company. As of October 1, 2017, we had approximately 4,530 employees (including 2 employees who are also members of our board of directors).

***Administration***

The cash component will be administered by our compensation committee or any other duly authorized committee of our board of the directors consisting of two or more “outside directors” within the meaning of Section 162(m) (in either case, the “administrator”). The administrator will select which of our employees (and employees of our affiliates) will be eligible to receive awards under the cash component for an applicable

performance period (the “cash component participants”). The actual number of cash component participants during any year cannot be determined in advance because the administrator has discretion to select the cash component participants.

#### *Performance Periods and Performance Goals*

Performance-based cash incentives may be payable to each cash component participant as a result of satisfying performance goals in a performance period. Each performance period has a length of one fiscal year or such other period as determined by the administrator. A cash component participant may be eligible for multiple and overlapping performance periods.

For each performance period, no later than the latest possible date that will not jeopardize the ability of an actual cash award to qualify as “performance-based compensation” under Section 162(m), the administrator will designate cash component participants for the performance period, select the performance goals applicable to the performance period, establish the methodology for calculating the maximum amount earned by satisfying such performance goals (the “payout calculation methodology”), and establish a target and maximum cash award for each cash component participant for the performance period.

The performance goals will be based on a specified list, as further discussed below in the section entitled “Performance Goals.” If a performance goal is based on or calculated with respect to shares of our common stock (“Shares”) and any specified corporate transaction occurs involving our company, the administrator will make equitable adjustments to the performance goal. To the extent identified in the payout calculation methodology, evaluation of performance may include or exclude certain business, financial and/or legal factors as specified by the administrator, as more fully described in the Incentive Plan.

#### *Actual Cash Awards*

Before any actual cash award is paid, the administrator must certify in writing to what extent the performance goal(s) were attained. The actual cash award payable to a cash component participant is determined using a pre-established formula that increases or decreases the cash component participant’s target award based on the level of actual performance certified by the administrator. The administrator has discretion to reduce or eliminate (but not to increase) the actual cash award of any cash component participant at any time prior to payment of the actual cash award.

Additionally, the cash component limits actual cash awards to a maximum of \$5,000,000 per cash component participant in any fiscal year, even if the formula otherwise indicates a larger award. If there are multiple performance periods ending in the same fiscal year, the aggregate amount paid with respect to all performance periods ending within that fiscal year cannot exceed the maximum specified in the previous sentence, and any excess will be forfeited.

Actual cash awards are paid in cash as soon as administratively practicable. If a cash component participant’s employment is terminated due to the cash component participant’s death or disability prior to the end of a performance period, the cash component participant (or in the event of death, the cash component participant’s beneficiaries) may receive a pro-rata portion of the target award as determined by the administrator. If a cash component participant’s employment is otherwise terminated during the performance period, the cash component participant will not have earned and will not be entitled to payment of any actual cash award.

### ***Equity Component***

#### *Eligibility*

Equity awards under the equity component may be issued to employees of our company or any parent or subsidiary of our company, consultants of our company or a parent or subsidiary of our company and our outside directors. As of October 1, 2017, we had approximately 4,530 employees (including 2 employees who are also members of our board of directors), 106 consultants and nine outside directors.

### *Shares Available for Issuance*

The equity component provides for the issuance of Shares through equity incentives in the form of stock options, restricted stock, restricted stock units, stock appreciation rights, performance units (which include any restricted stock units that may be earned in whole or in part upon attainment of performance goals or performance objectives in accordance with the same terms as applicable to performance units under the equity component) and performance shares (collectively, “equity awards”) as the administrator may determine. Shares underlying equity awards will be issued from the 2012 Equity Incentive Plan (“2012 Plan”).

### *Annual Limits*

The equity component contains annual grant limits intended to satisfy Section 162(m). Specifically, the maximum number of Shares covered by or the maximum initial value of equity awards that can be granted to any particular employee under the equity component (each, an “equity component participant”) in any fiscal year is set forth below:

<u>Award Type</u>	<u>Annual Limit on Number of Shares or Initial Value</u>
Stock Options	Maximum of 500,000 Shares (plus an additional 500,000 Shares in connection with the equity component participant’s initial service as an employee)
Restricted Stock	Maximum of 250,000 Shares (plus an additional 250,000 Shares in connection with the equity component participant’s initial service as an employee)
Restricted Stock Units	Maximum of 250,000 Shares (plus an additional 250,000 Shares in connection with the equity component participant’s initial service as an employee)
Stock Appreciation Rights	Maximum of 500,000 Shares (plus an additional 500,000 Shares in connection with the equity component participant’s initial service as an employee)
Performance Shares	Maximum of 250,000 Shares (plus an additional 250,000 Shares in connection with the equity component participant’s initial service as an employee)
Performance Units	Maximum of 250,000 Shares (plus an additional 250,000 Shares in connection with the equity component participant’s initial service as an employee). In the case of any cash-settled performance units, the annual limit will be the dollar value based on the product of 250,000 Shares (or an additional 250,000 Shares for the equity component participant’s initial service as an employee) multiplied by the fair market value of a Share as of the trading day prior to the Annual Meeting)

The Incentive Plan also provides that in any fiscal year, a non-employee board member may not be paid cash compensation and granted equity awards with an aggregate value (determined as fair value in accordance with United States generally accepted accounting principles (“GAAP”)) exceeding \$2,000,000 (increased to \$4,000,000 in the fiscal year his or her service as an outside director begins).

In the event of any dividend or other distribution (whether in the form of cash, Shares, other securities, or other property), recapitalization, stock split, reverse stock split, reorganization, merger, consolidation, split-up, spin-off, combination, repurchase or exchange of Shares or other securities or other change in the corporate structure affecting our common stock, the administrator, in order to prevent diminution or enlargement of the benefits or potential benefits intended to be made available under the equity component, will adjust the number, class and price of Shares subject to outstanding equity awards, and the equity award grant limitations discussed above.

### *Administration*

The administrator will administer the equity component. To make grants to certain officers and key employees, the members of the applicable committee must qualify as “non-employee directors” under Rule 16b-3 of the Exchange Act.

Subject to the terms of the Incentive Plan, the administrator has the sole discretion to determine fair market value; to select the employees who will receive equity awards; to determine the number of Shares covered by each equity award; to determine the terms and conditions of equity awards; to approve forms of equity award agreements for use under the equity component; to modify or amend each equity award; and to construe and interpret the provisions of the equity component and outstanding equity awards. The administrator may allow an equity component participant to defer the receipt of payment of cash or delivery of Shares that would otherwise be due to such equity component participant under an equity award. The administrator may make rules and regulations relating to sub-plans established for the purpose of satisfying applicable foreign laws and may make all other determinations deemed necessary or advisable for administering the equity component. The administrator will issue all equity awards pursuant to the terms and conditions of the equity component.

Notwithstanding the foregoing, the administrator may not implement a program allowing for the cancellation of equity awards in exchange for different awards, awards of the same type, and/or cash, the transfer of an outstanding equity award to a financial institution or other person or entity selected by the administrator, or the increase or reduction of the exercise price of any outstanding equity award.

#### *Stock Options*

Each option granted under the equity component will be evidenced by an equity award agreement specifying the number of Shares subject to the option and the other terms and conditions of the option, consistent with the requirements of the equity component.

The exercise price per Share of each option may not be less than the fair market value of a Share on the date of grant. However, any incentive stock option granted to a person who at the time of grant owns stock possessing more than 10% of the total combined voting power of all classes of our stock or any parent or subsidiary corporation of ours (a “ten percent stockholder”) must have an exercise price per share equal to at least 110% of the fair market value of a Share on the date of grant. The aggregate fair market value of the Shares (determined on the grant date) covered by incentive stock options which first become exercisable by any equity component participant during any calendar year also may not exceed \$100,000. The fair market value of the common stock is generally the closing sales price of our stock as reported on the New York Stock Exchange.

Options will be exercisable at such times or under such conditions as determined by the administrator and set forth in the equity award agreement, which will include performance goals from a specified list, as further discussed below in the section entitled “Performance Goals.” The term of an option will be specified in the equity award agreement, but the term of an incentive stock option may not be more than ten years (or five years if granted to a ten percent stockholder).

Upon the termination of an equity component participant’s active service, the unvested portion of the equity component participant’s option generally expires. The vested portion of the option will remain exercisable for the period following the equity component participant’s termination of active service that was determined by the administrator and specified in the equity component participant’s equity award agreement, and if no such period was determined by the administrator, the vested portion of the option will remain exercisable for: (i) three months following a termination of the equity component participant’s active service for reasons other than death or disability or (ii) 12 months following a termination of the equity component participant’s active service due to death or disability. In no event will the option be exercisable after the end of the option’s term.

The administrator will determine the acceptable form(s) of consideration for exercising an option. An option will be deemed exercised when we receive the notice of exercise and full payment for the Shares to be exercised, together with applicable tax withholdings.

#### *Restricted Stock*

Equity awards of restricted stock are rights to acquire or purchase Shares that vest in accordance with the terms and conditions established by the administrator in its sole discretion. Each equity award of restricted stock

granted under the equity component will be evidenced by an equity award agreement specifying the number of Shares subject to the equity award of restricted stock and the other terms and conditions of the equity award of restricted stock, consistent with the requirements of the equity component. The administrator will determine the vesting criteria that apply to an award of restricted stock. Such vesting criteria will include performance goals from a specified list, as further discussed below in the section entitled “Performance Goals.”

Unless the administrator provides otherwise, participants holding Shares of restricted stock will have voting rights and rights to dividends and other distributions with respect to such Shares without regard to vesting. However, such dividends or other distributions will be subject to the same restrictions and forfeitability provisions that apply to the Shares of restricted stock with respect to which they were paid. The administrator has the discretion to reduce or waive any restrictions and to accelerate the time at which any restrictions will lapse or be removed.

An equity component participant will forfeit any Shares of restricted stock that have not vested by the termination of the equity component participant’s service.

#### *Restricted Stock Units*

A restricted stock unit represents a right to receive cash or a Share if the vesting criteria set by the administrator are achieved or the restricted stock unit otherwise vests. Each award of restricted stock units granted under the equity component will be evidenced by an equity award agreement specifying the number of Shares subject to the equity award and other terms and conditions of the equity award, consistent with the requirements of the equity component.

The administrator may set vesting criteria based upon the achievement of company-wide, divisional, business unit or individual goals (such as continued employment or service), applicable federal or state securities laws, or any other basis determined by the administrator, in its discretion. Such vesting criteria will include performance goals from a specified list, as further discussed below in the section entitled “Performance Goals.”

After an equity award of restricted stock units has been granted, the administrator has the discretion to reduce or waive any vesting criteria that must be met to receive a payout. An equity component participant will forfeit any unearned restricted stock units upon termination of his or her service. The administrator in its sole discretion may only settle earned restricted stock units in cash, Shares, or a combination of both.

An equity component participant will forfeit any restricted stock units that have not been earned or have not vested as of the termination of his or her service with us.

#### *Stock Appreciation Rights*

A stock appreciation right gives an equity component participant the right to receive the appreciation in the fair market value of our common stock between the date the equity award is granted and the date it is exercised. Upon exercise of a stock appreciation right, the holder of the equity award will be entitled to receive an amount determined by multiplying: (i) the difference between the fair market value of a Share on the date of exercise and the exercise price by (ii) the number of exercised stock appreciation rights. We may pay the appreciation in cash, in Shares, or a combination of both. Each stock appreciation right granted under the equity component will be evidenced by an equity award agreement specifying the exercise price and the other terms and conditions of the equity award.

The exercise price per Share of each stock appreciation right may not be less than the fair market value of a Share on the date of grant. Stock appreciation rights will be exercisable at such times or under such conditions as determined by the administrator and set forth in the equity award agreement, which will include performance goals from a specified list, as further discussed below in the section entitled “Performance Goals.” The term of a



stock appreciation right may not be more than ten years. The terms and conditions relating to the period of exercise of stock appreciation rights following the termination of an equity component participant's active service are similar to those for options described above.

#### *Performance Units and Performance Shares*

Performance units and performance shares are equity awards that will result in a payment to an equity component participant only if the performance goals, performance objectives, or other vesting provisions established by the administrator are achieved or the equity awards otherwise vest. Performance units will have an initial value established by the administrator on or before the date of grant. Each performance share will have an initial value equal to the fair market value of a Share on the grant date.

Performance units or performance shares granted under the equity component will be evidenced by an equity award agreement specifying the performance period and other terms and conditions of the equity award. The administrator may set vesting criteria based upon the achievement of company-wide, divisional, business unit or individual goals (such as continued employment or service), applicable federal or state securities laws, or any other basis determined by the administrator, in its discretion. Such vesting criteria will include performance goals from a specified list, as further discussed below in the section entitled "Performance Goals."

After performance units or performance shares have been granted, the administrator has the discretion to reduce or waive any performance objectives or other vesting provisions for such performance units or performance shares, but the administrator may not increase the amount payable at a given level of performance.

The administrator has the discretion to pay earned performance units or performance shares in the form of cash, Shares (which will have an aggregate fair market value equal to the earned performance units or performance shares at the close of the applicable performance period), or a combination of both.

An equity component participant will forfeit any performance units or performance shares that have not been earned or have not vested as of the termination of his or her service with us.

#### *Equity Award Performance Goals*

The granting and/or vesting of restricted stock, restricted stock units, performance shares and performance units under the equity component shall be made subject to satisfying performance goals in a performance period. Each performance period has a length of one fiscal year or such other period as determined by the administrator. An equity component participant may be eligible for multiple and overlapping performance periods. The performance goals will be based on a specified list, as further discussed below in the section entitled "Performance Goals."

To the extent necessary to comply with the performance-based compensation provisions of Section 162(m), no later than the latest possible date that will not jeopardize the ability of an equity award to qualify as "performance-based compensation" under Section 162(m), the administrator will in writing: (i) designate one or more equity component participants to whom an equity award will be made; (ii) select the performance goals applicable to the performance period; (iii) establish the performance goals, and amounts of such equity awards, as applicable, which may be earned for such performance period; and (iv) specify the relationship between performance goals and the amounts of such equity awards, as applicable, to be earned by each equity component participant for such performance period. Following the completion of each performance period, the administrator will certify in writing whether the applicable performance goals have been achieved for such performance period. In determining the amounts earned by an equity component participant, the administrator may reduce or eliminate (but not increase) the amount payable at a given level of performance to take into account additional factors that the administrator may deem relevant to the assessment of individual or corporate performance for the performance period. An equity component participant will be eligible to receive payment pursuant to an equity award for a performance period only if the performance goals for such period are achieved.

### *Transferability of Awards*

Equity awards generally are not transferable other than by will or by the laws of descent or distribution.

### *Dissolution or Liquidation*

In the event of a proposed dissolution or liquidation of our company, the administrator will notify each equity component participant as soon as practicable prior to the effective date of such proposed transaction. An equity award will terminate immediately prior to consummation of such proposed action to the extent the equity award has not been previously exercised.

### *Change in Control*

The equity component provides that, in the event of a merger of the Company with or into another corporation or other entity or a change in control (as defined in the Incentive Plan), each outstanding equity award will be treated as the administrator determines, including that each equity award be assumed or an equivalent option or right substituted by the successor corporation or a parent or subsidiary of the successor corporation. The administrator will not be required to treat all outstanding equity awards the same in the transaction.

If the successor corporation does not assume or substitute for the equity award, the equity component participant will fully vest in and have the right to exercise all of his or her outstanding options and stock appreciation rights, and with respect to equity awards with performance-based vesting, all performance goals or other vesting criteria will be deemed achieved at 100% of target levels and all other terms and conditions met. In addition, if an option or stock appreciation right is not assumed or substituted for, the administrator will notify the equity component participant in writing or electronically that the option or stock appreciation right will be exercisable for a period of time determined by the administrator, in its sole discretion, and the option or stock appreciation right will terminate upon the expiration of such period.

For equity awards granted to an outside director that are assumed or substituted for, if on the date of or following such assumption or substitution the outside director's status as a director of ours or of the successor corporation is terminated other than upon the outside director's voluntary resignation that is not made at the request of the acquirer, then the outside director will fully vest in and have the right to exercise options and stock appreciation rights, all restrictions on restricted stock and restricted stock units will lapse, and, with respect to performance units and performance shares, all performance goals or other vesting criteria will be deemed achieved at 100% of target levels and all other terms and conditions met.

### *Performance Goals*

The performance goals require the achievement of objectives for one or more of the following measures: cash flow (including operating cash flow or free cash flow), revenue (on an absolute basis or adjusted for currency effects), gross margin, operating expenses or operating expenses as a percentage of revenue, earnings (which may include earnings before interest and taxes, earnings before taxes, net earnings or EBITDA), earnings per share, stock price, return on equity, total stockholder return, growth in stockholder value relative to the moving average of the S&P 500 Index or another index, return on capital, return on assets or net assets, return on investment, operating income or net operating income, operating margin, market share, overhead or other expense reduction, objective customer indicators, improvements in productivity, attainment of objective operating goals, objective employee metrics, return ratios, objective qualitative milestones, or other objective financial or other metrics relating to the progress of our company, any parent, subsidiary, or affiliate of our company, or any of their divisions or departments.

These measures may be applied to either our company or, except regarding stockholder return metrics, to a region, business unit, affiliate or business segment, and measured either on an absolute basis, a per share basis or

relative to a pre-established target, to a previous period's results or to a designated comparison group, and, with respect to financial metrics, which may be determined under GAAP, under accounting principles established by the International Accounting Standards Board ("IASB Principles") or which may be adjusted when established to exclude any items otherwise includable under GAAP or under IASB Principles. Each performance goal may be expressed on an absolute and/or relative basis, may be based on, or otherwise employ, comparisons based on internal targets, the past performance of our company and/or the past or current performance of other companies.

Unless the administrator provides otherwise as described in the previous paragraph, performance goals will be calculated in accordance with our company's financial statements, generally accepted accounting principles, or under a methodology established by the administrator prior to or at the time of the issuance of an equity award and which is consistently applied with respect to a performance goal in the relevant performance period.

#### ***Forfeiture Events***

Each actual cash award and equity award granted under the Incentive Plan will be subject to recoupment under any clawback policy that, in the future, we are required by applicable stock exchange rules or applicable laws to adopt (including any such clawback policy that is adopted after the grant of such award), and the administrator also may impose such other clawback, recovery, or recoupment provisions in an agreement governing such award as the administrator determines necessary or appropriate. In the event of any accounting restatement, the recipient of such award will be required to repay a portion of the proceeds received in connection with the settlement of such award earned or accrued under certain circumstances.

#### ***Amendment or Termination***

If approved by our stockholders, the Incentive Plan will automatically terminate five years from the date of the Annual Meeting, unless terminated at an earlier time by our board of directors or the administrator. Our board of directors or the administrator may amend, alter, suspend, or terminate the Incentive Plan at any time. However, the amendment, alteration, suspension, or termination of the Incentive Plan will not, unless mutually agreed otherwise in a signed writing between the Incentive Plan participant and the administrator, materially impair the rights of any Incentive Plan participant, except that the administrator may amend, alter, suspend or terminate the Incentive Plan if such action is done: in a manner permitted under the Incentive Plan, to avoid additional tax or income recognition under Section 409A of the Code, to comply with applicable laws, or as necessary to ensure compliance with the requirements of Section 162(m). The administrator, in its sole determination, determines whether an amendment, alteration, suspension, or termination materially impairs the rights of any participant. We will obtain stockholder approval of any amendment to the Incentive Plan to the extent such approval is necessary or desirable to comply with applicable laws.

#### ***Summary of U.S. Federal Income Tax Consequences***

The following summary is intended only as a general guide to the U.S. federal income tax consequences of participation in the Incentive Plan. The summary is based on existing U.S. laws and regulations as of the record date of the Annual Meeting, and there can be no assurance that those laws and regulations will not change in the future. The summary does not purport to be complete and does not discuss the tax consequences upon an equity component participant's death, or the provisions of the income tax laws of any municipality, state or foreign country in which the equity component participant may reside. As a result, tax consequences for any particular equity component participant may vary based on individual circumstances.

#### ***Actual Cash Awards***

Cash component participants will recognize ordinary income equal to the amount of the actual cash award received in the year of receipt. That income will be subject to applicable income and employment tax withholding by our company.

### *Incentive Stock Options*

An equity component participant recognizes no taxable income for regular income tax purposes as a result of the grant or exercise of an option that qualifies as incentive stock option under Section 422 of the Code. If an equity component participant exercises the option and then later sells or otherwise disposes of the Shares acquired through the exercise the option after both the two-year anniversary of the date the option was granted and the one-year anniversary of the exercise, the equity component participant will recognize a capital gain or loss equal to the difference between the sale price of the Shares and the exercise price, and we will not be entitled to any deduction for federal income tax purposes.

However, if the equity component participant disposes of such Shares either on or before the two-year anniversary of the date of grant or on or before the one-year anniversary of the date of exercise (a “disqualifying disposition”), any gain up to the excess of the fair market value of the Shares on the date of exercise over the exercise price generally will be taxed as ordinary income, unless the Shares are disposed of in a transaction in which the equity component participant would not recognize a loss (such as a gift). Any gain in excess of that amount will be a capital gain. If a loss is recognized, there will be no ordinary income, and such loss will be a capital loss. Any ordinary income recognized by the equity component participant upon the disqualifying disposition of the Shares generally should be deductible by us for federal income tax purposes, except to the extent such deduction is limited by applicable provisions of the Code.

For purposes of the alternative minimum tax, the difference between the option exercise price and the fair market value of the Shares on the exercise date is treated as an adjustment item in computing the equity component participant’s alternative minimum taxable income in the year of exercise. In addition, special alternative minimum tax rules may apply to certain subsequent disqualifying dispositions of the Shares or provide certain basis adjustments or tax credits for purposes.

### *Nonstatutory Stock Options*

An equity component participant generally recognizes no taxable income as the result of the grant of such an option. However, upon exercising the option, the equity component participant normally recognizes ordinary income equal to the amount that the fair market value of the Shares on such date exceeds the exercise price. If the equity component participant is an employee, such ordinary income generally is subject to withholding of income and employment taxes. Upon the sale of the Shares acquired by the exercise of a nonstatutory stock option, any gain or loss (based on the difference between the sale price and the fair market value on the exercise date) will be taxed as capital gain or loss. No tax deduction is available to us with respect to the grant of a nonstatutory stock option or the sale of the Shares acquired through the exercise of the nonstatutory stock option.

### *Stock Appreciation Rights*

In general, no taxable income is reportable when a stock appreciation right is granted to an equity component participant. Upon exercise, the equity component participant generally will recognize ordinary income in an amount equal to the fair market value of any Shares received. Any additional gain or loss recognized upon any later disposition of the Shares would be capital gain or loss.

### *Performance Shares and Performance Units*

An equity component participant generally will recognize no income upon the grant of a performance share or a performance unit award. Upon the settlement of such awards, equity component participants normally will recognize ordinary income in the year of receipt in an amount equal to the cash received and the fair market value of any cash or unrestricted Shares received. If the equity component participant is an employee, such ordinary income generally is subject to withholding of income and employment taxes. Upon the sale of any Shares received, any gain or loss, based on the difference between the sale price and the fair market value on the date the ordinary income tax event occurs, will be taxed as capital gain or loss.

### *Section 409A*

Section 409A of the Code requires that amounts that qualify as “nonqualified deferred compensation” satisfy requirements with respect to the timing of deferral elections, timing of payments, and certain other matters.

Section 409A provides certain requirements for non-qualified deferred compensation arrangements with respect to an individual’s deferral and distribution elections and permissible distribution events. Any award granted under the Incentive Plan with a deferral feature will be subject to the requirements of Section 409A. If that award fails to satisfy such requirements, the recipient of the award may recognize ordinary income on the amounts deferred under the award to the extent the award is vested (which may be prior to when the compensation is actually or constructively received), and the recipient of the award may be subject to an additional 20% federal income tax, penalties, and interest charges on that ordinary income.

### *Tax Effect for Our Company*

We generally will be entitled to a tax deduction in connection with actual cash awards and equity awards granted under the Incentive Plan in an amount equal to the ordinary income realized by an Incentive Plan participant when the Incentive Plan participant recognizes such income, except to the extent such deduction is limited by applicable provisions of the Code. Under Section 162(m), the annual compensation paid to any of our “covered employees” (which includes our chief executive officer) generally will be deductible only to the extent that it does not exceed \$1,000,000. However, we can preserve the deductibility of “performance-based compensation” in excess of \$1,000,000 if certain conditions are met, such as obtaining stockholder approval of the Incentive Plan and its material terms, setting limits on the number of actual cash awards and equity awards that any individual may receive and, except for certain stock options and stock appreciation rights, establishing performance criteria that must be met before such awards actually will vest or be paid. The Incentive Plan has been designed to permit (but not require) the administrator to grant actual cash awards and equity awards that are intended to qualify as “performance-based compensation” for purposes of satisfying the conditions of Section 162(m).

THE FOREGOING IS ONLY A SUMMARY OF THE EFFECT OF U.S. FEDERAL INCOME TAXATION UPON INCENTIVE PLAN PARTICIPANTS AND OUR COMPANY WITH RESPECT TO AWARDS UNDER THE INCENTIVE PLAN. IT DOES NOT PURPORT TO BE COMPLETE AND DOES NOT DISCUSS THE IMPACT OF EMPLOYMENT OR OTHER TAX REQUIREMENTS, THE TAX CONSEQUENCES OF AN INCENTIVE PLAN PARTICIPANT’S DEATH, OR THE PROVISIONS OF THE INCOME TAX LAWS OF ANY MUNICIPALITY, STATE, OR FOREIGN COUNTRY.

## New Plan Benefits

The amount of the actual cash award that an employee may receive under the Incentive Plan is determined based on actual future performance, and the number of equity awards that a service provider may receive under the Incentive Plan determined by our compensation committee each year. Therefore, the amount of such actual cash awards and the number of such equity awards cannot be determined in advance. The following table sets forth: (1) the actual cash incentive paid under the applicable cash incentive compensation plan for fiscal 2017, for each of the persons and groups shown below, and (2) the aggregate number of shares of our common stock covered by restricted stock awards (including performance-based restricted stock awards, or “PSAs”) under the 2012 Plan during fiscal 2017, to the persons and groups shown below.

Name of Individual or Group	FY17 Cash Incentive Compensation (1)	Number of Shares Covered by Equity Awards (#) (2)	Dollar Value of Equity Awards (\$) (3)
Mark D. McLaughlin, . . . . . <i>Chief Executive Officer</i>	\$ 0	64,804	\$ 9,625,986
Steffan C. Tomlinson, . . . . . <i>Executive Vice President, Chief Financial Officer</i>	\$ 0	25,920	\$ 3,850,157
Nir Zuk, . . . . . <i>Executive Vice President, Chief Technology Officer</i>	\$ 0	25,920	\$ 3,850,157
René Bonvanie, . . . . . <i>Executive Vice President, Chief Marketing Officer</i>	\$ 0	19,440	\$ 2,887,618
Mark F. Anderson, . . . . . <i>President</i>	\$ 0	38,882	\$ 5,775,532
All current executive officers as a group (4) . . . . .	\$ 0	213,848	\$ 31,764,982
All non-employee directors as a group (5) . . . . .	—	20,438	\$ 2,786,012
All other employees who are not executive officers, as a group . . . .	\$363,469,533	3,889,973	\$550,444,853

- (1) As noted in the Fiscal 2017 Summary Compensation Table, our Named Executive Officers were not paid any incentive compensation with respect to fiscal 2017. The following represents each Named Executive Officer’s target incentive opportunity during fiscal 2017: (i) Mark D. McLaughlin, \$783,750; (ii) Steffan C. Tomlinson, \$273,750; (iii) Nir Zuk, \$205,625; (iv) René Bonvanie, \$180,625; and (v) Mark F. Anderson, \$438,000.
- (2) This column represents the Shares covered by restricted stock awards (with respect to PSAs, based on the number of Shares earned at target levels of performance) granted under the 2012 Equity Incentive Plan.
- (3) Reflects the aggregate grant date fair value of equity awards (with respect to PSAs, based on the number of Shares earned at target levels of performance) computed in accordance with FASB ASC Topic 718.
- (4) In addition to individuals listed above, our list of current executive officers includes Lee Klarich, who became an executive officer during fiscal 2018.
- (5) The individuals in this group are not eligible to participate in the cash component of the Incentive Plan.

## Recommendation of Our Board of Directors

Our board of directors unanimously recommends that you vote “FOR” the approval of the Incentive Plan. Approval of this proposal requires the affirmative vote of a majority of the shares of our common stock present in person or by proxy at the Annual Meeting and entitled to vote thereon to be approved. You may vote “for,” “against,” or “abstain” with respect to this proposal. Abstentions are considered votes present and entitled to vote on this proposal, and thus will have the same effect as a vote “against” this proposal. Broker non-votes will have no effect on the outcome of this proposal.

**PROPOSAL NO. 5**  
**STOCKHOLDER PROPOSAL RELATING TO DIVERSITY REPORT**

Trillium Asset Management, LLC, located at Two Financial Center, 60 South Street, Suite 1100, Boston, MA 02111, has advised us that they plan to introduce the following resolution on behalf of William A. Gee IV. Mr. Gee is the beneficial holder of at least \$2,000 in market value of the Company's common stock.

**WHEREAS:**

McKinsey & Company found companies with highly diverse executive teams had higher returns on equity and earnings performance than those with low diversity.

Palo Alto Network states that its "commitment to women in technology is evident through our partnerships with the Anita Borg Institute and other organizations promoting diversity."

However, the Company does not disclose workforce data or share results of diversity and inclusion initiatives.

Lack of diversity among high tech workers is a central public concern according to the U.S. Equal Employment Opportunity Commission. In 2014, the Commission reported that the high-tech sector employed a larger share of whites, Asian Americans, and men, and a smaller share of African-Americans, Hispanics and women than the "overall private industry."

Industry peers including Cisco and HP provide EEO-1 data. Intel discloses EEO-1 data and diversity goals. In 2015, the company set a public, time-bound goal for hiring women and underrepresented minorities and tied a portion of employee variable compensation to achieving its goal. In August 2015 Intel reported that it exceeded its target of 40 percent hires of women, blacks, Hispanics and Native Americans in the first six months of the year.

More than two dozen startups and venture capital firms, motivated by the efforts of Kapor Capital, have begun sharing strategies and setting diversity metrics.

Further, research from Mercer confirms that improving gender diversity will require attention to closing the gender pay gap. And, owing to concern about gender and racial wage disparities, the EEOC announced in January 2016 a proposed rule to stem wage discrimination by collecting pay data by gender, race and ethnicity.

Expanding workforce diversity and closing the wage gap requires policies that attract and retain diversity in the workplace. A company's family leave policies, for example, can play a role. McKinsey reports that paid parental leave and the availability of on-site child care can impact women's ability to move into higher productivity roles. The best performing companies on gender diversity have implemented gender neutral policies that improve the workplace for both men and women, according to McKinsey.

Diversity benchmarks can help ensure companies create workforces necessary to compete effectively. In our view, companies that are publicly accountable to diversity goals are most likely to make rapid progress toward achieving those goals.

**RESOLVED:** Shareholders request that Palo Alto Networks prepare a diversity report, at reasonable cost and omitting confidential information, available to investors including:

1. A chart identifying employees according to gender and race in major EEOC-defined job categories, listing numbers or percentages in each category;
2. A description of policies/programs focused on increasing diversity in the workplace.

**Shareholder Supporting Statement:** A report adequate for investors to assess strategy and performance would include a review of appropriate time-bound benchmarks for judging current and future progress, and details of practices designed to reduce unconscious bias in hiring and to build mentorship among staff of color.

## **COMPANY'S OPPOSITION STATEMENT**

The board of directors unanimously recommends that you vote "AGAINST" this proposal.

We are committed to diversity in our workforce and recognize diversity as a business imperative. The board of directors continuously oversees our diversity efforts and monitors our progress toward increasing diversity.

The board of directors does not believe that preparing a report identifying employees according to standardized EEOC-defined job categories or describing our diversity efforts would enhance our efforts to encourage diversity and create a diverse workforce.



## EXECUTIVE OFFICERS

The following table identifies certain information about our executive officers as of October 23, 2017. Officers are elected by our board of directors to hold office until their successors are elected and qualified.

<u>Name</u>	<u>Age</u>	<u>Position(s)</u>
Mark D. McLaughlin . . . . .	51	Chief Executive Officer and Chairman
Steffan C. Tomlinson . . . . .	45	Chief Financial Officer
Nir Zuk . . . . .	46	Chief Technology Officer and Director
René Bonvanie . . . . .	56	Chief Marketing Officer
Mark F. Anderson . . . . .	55	President
Lee Klarich . . . . .	42	Chief Product Officer

*Mark D. McLaughlin* has served as our Chief Executive Officer and as a member of our board of directors since August 2011, and as the Chairman of our board of directors since April 2012. From July 2011 through August 2016, Mr. McLaughlin also served as our President. From August 2009 through July 2011, Mr. McLaughlin served as President and Chief Executive Officer and as a director at VeriSign, Inc., a provider of Internet infrastructure services, and from January 2009 to August 2009, Mr. McLaughlin served as President and Chief Operating Officer at VeriSign. From February 2000 through November 2007, Mr. McLaughlin served in several roles at VeriSign, including as Executive Vice President, Products and Marketing. Prior to joining VeriSign, Mr. McLaughlin was Vice President, Sales and Business Development at Signio Inc., an Internet payments company acquired by VeriSign in February 2000. In January 2011, President Barack Obama appointed Mr. McLaughlin to serve on the President’s National Security Telecommunications Advisory Committee. Mr. McLaughlin currently serves on the board of directors of Qualcomm, Inc., a global semiconductor company that designs and markets wireless telecommunications products and services, and previously served on the board of directors of Opower, Inc., a provider of cloud based software to the utility industry. Mr. McLaughlin holds a B.S. from the U.S. Military Academy at West Point and a J.D. from Seattle University School of Law.

*Steffan C. Tomlinson* has served as our Chief Financial Officer since February 2012. From September 2011 to January 2012, Mr. Tomlinson was Chief Financial Officer at Arista Networks, Inc., a provider of cloud networking solutions. From April 2011 to September 2011, Mr. Tomlinson was a Partner and Chief Administrative Officer at Silver Lake Kraftwerk, a private investment firm. From September 2005 to March 2011, Mr. Tomlinson was Chief Financial Officer of Aruba Networks, Inc., a provider of intelligent wireless LAN switching systems. From 2000 until its acquisition by Juniper Networks, Inc., a supplier of network infrastructure products and services, in 2005, Mr. Tomlinson served in several roles, including Chief Financial Officer, at Peribit Networks, Inc., a provider of WAN optimization technology. Mr. Tomlinson holds an M.B.A. from Santa Clara University and a B.A. in Sociology from Trinity College.

*Nir Zuk* is one of our founders and has served as our Chief Technology Officer and as a member of our board of directors since March 2005. From April 2004 to March 2005, Mr. Zuk was Chief Security Technologist at Juniper Networks, Inc., a supplier of network infrastructure products and services. From September 2002 until its acquisition by Juniper in April 2004, Mr. Zuk was Chief Technology Officer at NetScreen Technologies, Inc., a provider of ASIC-based Internet security systems. In December 1999, Mr. Zuk co-founded OneSecure, Inc., a provider of prevention and detection appliances, and was Chief Technical Officer until its acquisition by NetScreen in September 2002. From 1994 to 1999, Mr. Zuk served in several technical roles, including Principal Engineer at Check Point Software Technologies Ltd., an enterprise software security company. Mr. Zuk attended Tel Aviv University where he studied Mathematics.

*René Bonvanie* has served as our Chief Marketing Officer since November 2011 and was our Vice President, Worldwide Marketing from September 2009 to November 2011. From June 2007 to August 2009, Mr. Bonvanie was Senior Vice President of Marketing, SaaS and Information Technology at Serena Software, Inc., a developer of information technology software. From January 2007 to June 2007, Mr. Bonvanie was Senior

Vice President and General Manager at salesforce.com, inc., a global enterprise software company. From March 2006 to January 2007, Mr. Bonvanie was Senior Vice President of Global Marketing at SAP AG, a software company. Mr. Bonvanie holds a B.A. in Economics from Vrije Universiteit Amsterdam.

*Mark F. Anderson* has served as our President since August 2016. Most recently Mr. Anderson served as our Executive Vice President, Worldwide Field Operations, a position he held from May 2016 through August 2016. From June 2012 when he joined the Company until May 2016, Mr. Anderson served as our Senior Vice President, Worldwide Field Operations. From October 2004 to May 2012, Mr. Anderson served in several roles, including as Executive Vice President of Worldwide Sales, for F5 Networks, an IT infrastructure company. From March 2003 to September 2004, Mr. Anderson served as Executive Vice President of North American Sales at Lucent Technologies, a telecommunications equipment and services company. Mr. Anderson holds a B.A. in Business and Economics from York University in Toronto, Canada.

*Lee Klarich* has served as our Chief Product Officer since August 2017. Prior to this appointment, Mr. Klarich served as our Executive Vice President of Product Management, a role he held since November 2015. From November 2012 to November 2015, Mr. Klarich served as our Senior Vice President, Product Management and our Vice President, Product Management from May 2006 to November 2012. Prior to joining us, Mr. Klarich held various positions at NetScreen Technologies, Excite@Home, and Packard Bell-NEC. Mr. Klarich holds a B.S. in Engineering from Cornell University.

## EXECUTIVE COMPENSATION

### Compensation Discussion and Analysis

Our Named Executive Officers, or NEOs, for fiscal 2017 were:

- Mark D. McLaughlin, our Chief Executive Officer, or CEO;
- Steffan C. Tomlinson, our Executive Vice President, Chief Financial Officer;
- Nir Zuk, our Executive Vice President, Chief Technology Officer;
- René Bonvanie, our Executive Vice President, Chief Marketing Officer; and
- Mark F. Anderson, our President.

### Executive Summary

Our goal is to align our executive pay with the success of our business. We do this by providing short-term cash incentive compensation opportunities tied to successful achievement of our annual operating goals and by granting long-term equity awards that are intended to deliver increasing value as our stock price increases, including, for the first time in fiscal 2017, performance-based stock awards tied to our financial performance.

Since our initial public offering, or IPO, in 2012, our business has grown rapidly, and this growth requires intense focus and dedication of our executives. Accordingly, we continue to design and update our executive compensation programs to match the maturity, size, scale and growth of our business. We operate in a highly competitive and rapidly evolving market, and our ability to compete and succeed in this dynamic environment is directly correlated to our ability to recruit, incentivize and retain talented and seasoned technology leaders. The market for skilled management and personnel in the security industry is fiercely competitive, therefore our executive compensation program is critical for the growth of our business.

This executive summary provides an overview of:

- (1) our fiscal 2017 business performance,
- (2) a summary of our executive compensation practices,
- (3) our stockholder engagement efforts, and
- (4) an overview of our fiscal 2017 executive compensation program.

### Fiscal 2017 Business Highlights

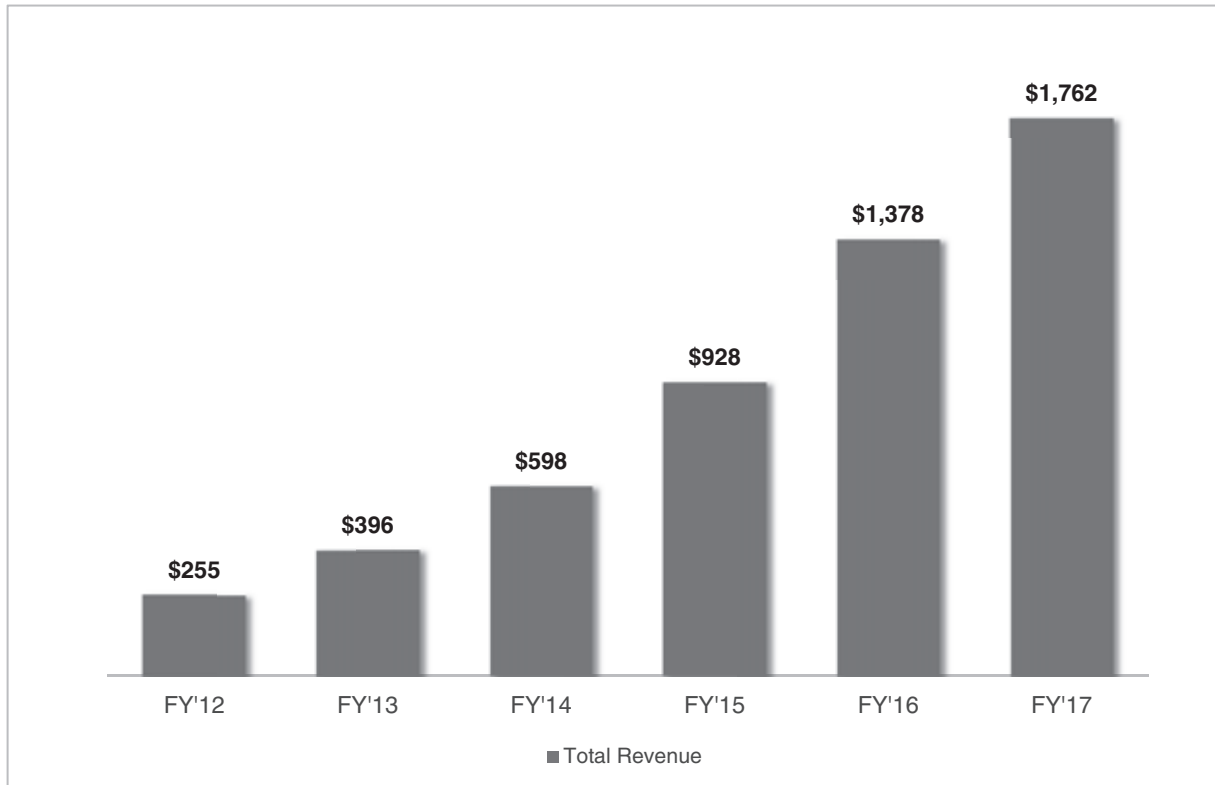
Our executive compensation program is designed to align the compensation of our executive officers with our operating and financial performance (both short-term and long-term) and create sustainable value for our stockholders. Our executive compensation actions and decisions should be viewed in the context of our financial and operational performance during fiscal 2017, as shown below:

<u>Dollars in millions</u>	<u>Fiscal 2016</u>	<u>Fiscal 2017</u>	<u>Change</u>
Total Revenue . . . . .	\$1,378.5	\$ 1761.6	27.8%
Net Cash provided by Operating Activities . . . . .	\$ 658.1	\$ 868.5	31.9%
Total Deferred Revenue . . . . .	\$1,240.8	\$1,773.5	42.9%
Billings . . . . .	\$1,905.6	\$2,293.4	20.4%
Approximate Number of Customers . . . . .	34,000	42,500	25.0%

Although net cash provided by operating activities, deferred revenue, billings and number of customers are not measures that were used to determine awards under our incentive compensation plan, we believe that these

results are important because our financial and operating performance measures are useful indicators for our compensation committee of our ability to grow our business consistent with our annual operating plan as it considers the compensation of our executives. Billings is a key financial measure and the calculation of billings to revenue is set forth in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” section on page 40 and 41 of our Annual Report on Form 10-K filed with the SEC on September 7, 2017. Note that the billings described in the table above is not the applicable billings metrics used for purposes of our performance-based stock awards. For purposes of our performance-based stock awards, we make certain adjustments to billings to exclude inorganic items such as post-acquisition billings from M&A.

**Strong Revenue Growth (in millions)**



**Executive Compensation Practices**

Our executive compensation program is designed to be heavily weighted towards compensating our executive officers based on our financial and operational performance. To that end, we have implemented executive compensation policies and practices that reinforce our pay for performance philosophy and align with sound governance principles. During fiscal 2017, the following policies and practices were in place:

**What we do:**

- Performance-based short-term cash incentive compensation that is entirely at-risk
- 100% independent directors on our compensation committee
- Independent compensation consultant directly engaged by and reporting to our compensation committee
- Annual review and approval of our compensation strategy
- Performance-based equity incentive awards that are entirely at-risk (new in fiscal 2017)

- Meaningful stock ownership guidelines for our executive officers and directors (new in fiscal 2017)
- Four-year vesting schedules for service-based equity awards granted in fiscal 2017 (new in fiscal 2017)
- Seek the recovery of performance-based incentive compensation paid by us under a Clawback Policy (new in fiscal 2018)

**What we don't do:**

- No “single trigger” change in control payments or benefits
- No post-employment retirement- or pension-type benefits for our executive officers that are not available to our employees generally
- No tax gross-ups for change in control payments or benefits
- No hedging or pledging of shares of our common stock

**Stockholder Engagement and our 2016 Say-on-Pay Vote**

Our compensation committee considers a number of factors in making executive compensation decisions, including the growth and scale of the company, recent performance against financial targets, a measured analysis of our compensation peer group practices and advice and analysis of competitive market conditions by its external compensation consultant. Our compensation committee also considers the results of each annual stockholder advisory vote on the compensation of our NEOs (the “Say-on-Pay” vote) and stockholder feedback on our executive compensation program. As part of our regular, ongoing and transparent communications with our stockholders we engage with our stockholders on a variety of topics through quarterly earnings calls, financial conferences, non-deal road shows and other communication channels. These discussions are generally attended by a combination of our CEO, Chief Financial Officer, Lead Independent Director (who serves on our compensation committee), General Counsel and/ or Vice President of Investor Relations.

At the beginning of fiscal 2017, prior to our 2016 Annual Meeting of Stockholders, our management team reached out to our top institutional and other stockholders representing an aggregate of approximately 42% of our outstanding shares to discuss their views about our executive compensation policies and practices as well as other matters. The stockholder engagement during fiscal 2017 was more targeted and more extensive than in prior years. The feedback received was presented to our nominating and corporate governance committee, compensation committee and board of directors.

As has been the compensation committee’s normal cadence for compensation decisions, in the first quarter of fiscal 2017, the compensation committee reviewed and approved the key elements of our fiscal 2017 executive compensation program. These decisions were made prior to receiving our 2016 Say-on-Pay voting results, where we received less than majority support for our 2016 Say-on-Pay proposal. In fiscal 2017, we made significant changes to our executive compensation program as set forth in the table below and in the section entitled “Fiscal 2017 Executive Compensation Program Changes and Decisions” below, in part based on the feedback received from our stockholders during our 2015 engagement efforts. It is the current intent of the compensation committee to continue to engage in a dialogue with the Company’s stockholders to solicit feedback regarding our executive compensation practices and programs.

<u>Compensation Component</u>	<u>Our Practice Prior to Fiscal 2017</u>	<u>Investor Feedback</u>	<u>Fiscal 2017 Changes</u>
Type of Equity Awards	As a public company, all equity awards granted to our named executive officers were time-based RSUs or RSAs.	Equity awards should include a meaningful amount of performance-based awards in addition to time-based awards.	We introduced PSAs in fiscal 2017. The fiscal 2017 long-term incentive compensation for our executive officers consists of 50% performance stock awards, or PSAs, and 50% restricted stock awards, or RSAs. The PSAs will be earned based upon achievement of billings performance. See below for additional information.
CEO Long-Term Incentive Compensation	Since joining our Company, our CEO, Mark McLaughlin, received: <ul style="list-style-type: none"> <li>• Pre-IPO new hire grant of stock options in fiscal 2012; and</li> <li>• Time-based equity awards in fiscal 2014, 2015 and 2016</li> </ul>	Our CEO’s fiscal 2015 RSU award was large in comparison to those granted to CEOs at our peer companies.	In fiscal 2017, our CEO was granted equity awards within market practices in comparison to those granted to CEOs at our peer companies of which 50% were PSAs and 50% were RSAs.
Vesting Schedule	Post-IPO time-vested equity awards granted to our executive officers vested over a period of approximately three years.	All equity awards should have a four-year vesting schedule.	In fiscal 2017, we adopted a four-year vesting schedule for the fiscal 2017 equity awards granted to our executive officers.  Additionally, the fiscal 2017 equity grants vesting schedules are heavily weighted towards the back end

<u>Compensation Component</u>	<u>Our Practice Prior to Fiscal 2017</u>	<u>Investor Feedback</u>	<u>Fiscal 2017 Changes</u>
Stock Ownership Guidelines	We had not adopted stock ownership guidelines, in part due to the significant existing equity holdings of our executive officers.	Executive officers and non-employee members of the Board of Directors should be subject to stock ownership guidelines.	of the service period to promote long-term incentives through the entire service period.  In fiscal 2017, we adopted stock ownership guidelines for our CEO, direct reports to our CEO and the non-employee members of the Board of Directors. See the section titled “Other Compensation Policies—Stock Ownership and Compensation Recovery Policies.”

### **Fiscal 2017 Executive Compensation Program Changes and Decisions**

Our executive compensation program continues to evolve as the company matures, gaining market share and growing, at scale, faster than the competition and the rate of the market. The changes to our executive compensation program for fiscal 2017, as further discussed below, were designed to enhance the link between executive pay and company financial performance, increase market alignment and mitigate risk, as well as respond to stockholder feedback on our compensation practices. The feedback from stockholders, along with the evolution of our fiscal planning process as we mature as a public company, and our compensation committee’s ongoing discussion about the appropriate time in our growth and evolution to implement performance-based equity awards, were factors towards implementing, for the first time in fiscal 2017, performance-based stock awards, or PSAs, tied to billings performance. Previously, we had only granted restricted stock awards, or RSAs, or restricted stock units, RSUs, subject to time-based vesting to our executive officers. In 2017, we believe that we have updated our executive compensation practices and governance in a manner appropriate for a company of our size, in our industry and our stage of growth. Further, our fiscal 2017 executive compensation program was measured against a new set of peer companies that we annually select as we grow. We intend to continue reviewing our executive compensation and governance practices as the company matures.

Below is a summary of the primary features of the fiscal 2017 PSAs, along with the rationale for our approach. See the section titled “Equity Compensation” for more information.

<u>PSA Feature</u>	<u>Our Approach</u>	<u>Our Rationale</u>
<b>Performance Measure</b>	100% billings performance	<ul style="list-style-type: none"> <li>• Billings is a growth indicator and the best measure of current performance given the company’s hybrid-SaaS revenue model.</li> </ul>

<u>PSA Feature</u>	<u>Our Approach</u>	<u>Our Rationale</u>
<b>Performance Target</b>	Billings target set based on growth expectations at the beginning of fiscal 2017 for fiscal 2017	<ul style="list-style-type: none"> <li>Align the interests of our executives with those of our stockholders through a performance target that correlates with the trajectory of our growth expectations.</li> <li>Minimum and maximum targets appropriately reward our executives for under or over-achievement of the target.</li> </ul>
<b>Performance Period</b>	One-year performance period, fiscal 2017	<ul style="list-style-type: none"> <li>Growth trajectory makes longer term performance projections difficult.</li> <li>Our historical financial outperformance of key operating measures.</li> <li>Risk of setting inappropriate target levels that may not align with our stockholders' interests if we were to project more than one year in advance.</li> <li>Long-term focus maintained by attaching an additional 3-year vesting schedule beyond the one-year performance period (see Vesting Schedule below). This balances the difficulty in predicting long-term performance while providing a long-term horizon for earning the compensation.</li> </ul>
<b>Vesting Schedule</b>	<p>Four-year vesting schedule</p> <p>For CEO: Vesting heavily weighted towards last two years of the service period, so long as he continues to be a service provider through each vesting date.</p> <p>For executive officers other than CEO: Vesting heavily weighted towards the latter three years of the service period, so long as the executive officer continues to be a service provider through each vesting date.</p>	<ul style="list-style-type: none"> <li>Additional time-based vesting schedule beyond satisfying the performance metric provides additional long-term incentives. A total of four-years of service is required for full vesting.</li> </ul>



As the company and the compensation program evolve and as we evaluate, including through stockholder discussions, the usefulness of performance-based stock awards in attaining our compensation objectives, our compensation committee intends to review and reconsider the mix of components in our long-term equity compensation, the appropriateness of PSA grants in future years, the metrics applicable to performance-based stock awards and the length of performance period for performance-based stock awards.

In addition to the inaugural PSA grants, in October 2016, our compensation committee approved the structure of our fiscal 2017 executive compensation, which is summarized in the chart below. In making these decisions, our compensation committee considered, among other factors, pay levels of our executive officers relative to the executives in comparable positions at the companies in our updated compensation peer group and the overall market, performance of each executive officer, the continued competition for experienced leadership in our industry and the feedback from our stockholders as discussed above.

<u>Compensation Component</u>	<u>Decision</u>	<u>Weighting of Performance Measures</u>
Base Salary	<p>CEO: Base salary increased by 25%; CEO base salary was set at or around the 50<sup>th</sup> percentile of our fiscal 2017 compensation peer group.</p> <p>Other NEOs: Base salary increased by approximately 4-19%; other NEO base salary was set at or around the 50<sup>th</sup>-75<sup>th</sup> percentile of our fiscal 2017 compensation peer group.</p>	N/A
Target Cash Incentive as a percentage as Base Salary	All NEOs: No change to the target annual incentive compensation opportunity as a percentage of base salary.	50% revenue and 50% earnings per share, subject to certain objective adjustments determined by our compensation committee
Long-Term Equity Incentives	<p>All NEOs: Granted equity awards consisting of mix of 50% PSAs and 50% RSAs</p> <p>Fiscal 2017 equity awards were targeted at or around the 60<sup>th</sup> and 75<sup>th</sup> percentile of our fiscal 2017 compensation peer group</p>	100% billings performance (for PSAs)

### **Fiscal 2017 Executive Compensation Highlights**

The key executive compensation decisions in fiscal 2017 were as follows:

- ***Competitive Market Analysis.*** Our compensation committee approved a revised compensation peer group for fiscal 2017. This compensation peer group was used to prepare a competitive market analysis that was used by our compensation committee to ensure that our executive compensation decisions for the year were positioned to be competitive with comparable peers in the market.
- In fiscal 2017, our total revenue increased by \$383.1 million and our non-GAAP earnings per share increased by \$0.82 per share compared to fiscal 2016. While our performance in each of these metrics increased from fiscal 2016, these results did not meet the significant stretch targets we set at the beginning of fiscal 2017. Because we did not achieve our desired revenue and earnings per share goals in fiscal 2017, we did not pay our NEOs under our Fiscal 2017 Incentive Compensation Plan. This is consistent with our “pay for performance” philosophy and demonstrates that our compensation is truly “at risk.”

- In fiscal 2017, our billings increased by \$387.2 million compared to fiscal 2016. This performance funded our performance-based stock awards at the 55% level.

#### **Subsequent Events—Relevant Fiscal 2018 Executive Compensation Highlights**

We continued sound corporate governance practice after fiscal 2017 year end as follows:

- We continued to grant equity awards to our named executive officers in the same vesting proportions as provided in fiscal 2017 (i.e., 50% solely time-based vesting and 50% performance-based vesting, with additional time-based requirements after the performance period).
- We adopted a Clawback Policy pursuant to which we may seek the recovery of performance-based incentive compensation paid by us.

## **DISCUSSION OF OUR FISCAL 2017 EXECUTIVE COMPENSATION PROGRAM**

This section provides an overview of our executive compensation philosophy, the overall objectives of our executive compensation program and each component of our executive compensation program. In addition, we explain how and why our compensation committee arrived at the specific compensation policies and decisions involving our executive officers for fiscal 2017.

### **Executive Compensation Philosophy and Objectives**

We operate in a highly competitive business environment, which is characterized by frequent technological advances, rapidly changing market requirements and the emergence of new market entrants. To successfully grow our business in this dynamic environment, we must continually develop and refine our products and services to stay ahead of our end-customers' needs and challenges. To achieve these objectives, we need a highly talented and seasoned team of technical, sales, marketing, operations, and other business professionals.

We compete with other companies in our industry and other technology companies in the San Francisco Bay Area to attract and retain a skilled management team. To attract and retain qualified executive candidates, our compensation committee recognizes that it needs to develop competitive compensation packages to meet this challenge, we have embraced a compensation philosophy of offering our NEOs a competitive total compensation program, each of the components of which recognizes and rewards individual performance and contributions to our success, allowing us to attract, retain, and motivate talented executive officers with the skills and abilities needed to drive our desired business results. The specific objectives of our executive compensation program are to:

- reward the successful achievement of our strategic and financial growth objectives;
- drive the development of a successful and profitable business;
- attract, motivate, reward, and retain highly qualified executive officers who are important to our success and possess the skills and leadership necessary to continue to grow our business;
- recognize strong performers by offering cash performance-based incentive compensation and equity awards that have the potential to reward individual achievement as well as contributions to our overall success; and
- create value for our stockholders and align the interests of our executive officers with those of our stockholders.

### **Compensation Program Design**

Our executive compensation program for fiscal 2017, reflected our stage of development as a growing publicly-traded company which is gaining market share and growing, at scale, faster than the competition and the rate of the market. Accordingly, we design our executive compensation program to provide market-competitive compensation in the form of base salary, a cash incentive compensation opportunity, equity awards, including both time-based RSAs and our inaugural grant of performance-based PSAs, and certain employee health and welfare benefits.

We offer cash compensation in the form of base salaries and annual cash incentive compensation opportunities (with semi-annual payouts). Typically, we have structured our cash incentive compensation opportunities to focus on the achievement of specific short-term financial and operational objectives that will further our longer-term growth objectives.

Additionally, equity awards for shares of our common stock serve as a key component of our executive compensation program. Currently, we grant full value awards, or awards without a purchase price including

RSUs, RSAs, and PSAs, to provide appropriate levels of compensation, to ensure that the recipient receives value for the shares regardless of fluctuations in the market price of our common stock, and to promote stockholder value creation (the value of a recipient's shares increases only as stockholder value increases). In the future, we may introduce other forms of equity awards, as we deem appropriate, that further our objective of providing long-term incentives to our NEOs while promoting stockholder value creation.

Finally, we offer our executive officers standard health and welfare benefits that are generally available to our other employees, including medical, dental, vision, life insurance and Section 401(k) savings plans.

We have not adopted any formal policies or guidelines for allocating compensation between current and long-term compensation or between cash and non-cash compensation, although we use competitive market data to develop a general framework for establishing the appropriate pay mix. Within this overall framework, our compensation committee reviews each component of executive compensation separately and also takes into consideration the value of each NEO's compensation package as a whole and its relative value in comparison to our other NEOs.

Our compensation committee evaluates our compensation philosophy and executive compensation program as circumstances require, and reviews executive compensation annually. As part of this review, we expect that our compensation committee will apply our philosophy and the objectives outlined above, together with consideration for the levels of compensation that we would be willing to pay to ensure that our executive compensation remains competitive and that we meet our retention objectives, as well as the cost to us if we were required to find a replacement for a key executive officer.

## **Compensation-Setting Process**

### ***Role of our Compensation Committee***

Compensation decisions for our NEOs are made by our compensation committee. Currently, our compensation committee is responsible for reviewing, evaluating and approving the compensation arrangements, plans, policies, and practices for our NEOs and overseeing and administering our cash-based and equity-based compensation plans.

Near the beginning of each fiscal year, our compensation committee, after consulting with our management team and its compensation consultant, makes decisions with respect to any base salary adjustment, and establishes the corporate performance objectives and target annual cash incentive compensation opportunities and equity awards for our executive officers, including our NEOs, for the upcoming fiscal year. With respect to our cash incentive compensation plan, our compensation committee determines the applicable target levels for each corporate performance objective used for each applicable quarterly performance measurement period.

Our compensation committee reviews our executive compensation program from time to time, including any incentive compensation plans, to determine whether they are appropriate, properly coordinated, and achieve their intended purposes, and to make any modifications to existing plans and arrangements or to adopt new plans or arrangements.

### ***Role of Management***

In carrying out its responsibilities, our compensation committee works with members of our management team, including our CEO and our Senior Vice President of Human Resources. Typically, our management team (together with our compensation committee's compensation consultant) assists our compensation committee in the execution of its responsibilities by providing information on corporate and individual performance, market data, and management's perspective and recommendations on compensation matters.

Typically, except with respect to his own compensation, our CEO will make recommendations to our compensation committee regarding compensation matters, including the compensation of our executive officers. Our CEO also participates in meetings of our compensation committee, except with respect to discussions involving his own compensation in which case he leaves the meeting.

While our compensation committee solicits the recommendations and proposals of our CEO with respect to compensation-related matters, these recommendations and proposals are only one factor in our compensation committee's decision-making process.

### ***Role of Compensation Consultant***

Our compensation committee has the authority to retain the services of external advisors, including compensation consultants, legal counsel and other advisors, from time to time, as it sees fit, in connection with carrying out its duties.

In fiscal 2017, our compensation committee continued to engage Compensia, Inc. ("Compensia"), a national compensation consulting firm, to assist us in executing our executive compensation strategy and guiding principles, assessing the current target total direct compensation opportunities of our executive officers, including comparing them against competitive market practices, developing a compensation peer group and advising on potential executive compensation decisions for fiscal 2017.

Compensia does not provide any services to us other than the services provided to our compensation committee. Our compensation committee has assessed the independence of Compensia taking into account, among other things, the factors set forth in Exchange Act Rule 10C-1 and the listing standards of the NYSE, and has concluded that no conflict of interest exists with respect to the work that Compensia performs for our compensation committee.

### ***Use of Competitive Data***

To assess the competitiveness of our executive compensation program and to assist in setting compensation levels, we refer to industry surveys, including the Radford High-Technology Executive Compensation Survey. In addition, during fiscal 2017, Compensia conducted an analysis of market data on the compensation peer group as approved by our compensation committee.

### ***Competitive Positioning***

In fiscal 2017, our compensation committee continued to compare and analyze our executive compensation with that of a formal compensation peer group of companies.

In the context of our annual executive compensation review, with assistance from Compensia and input from management, our compensation committee approved a peer group of publicly-traded technology companies, which met some or all of the following criteria: (i) operated in a high-technology industry, (ii) annual revenue approximately between \$1 billion and \$3 billion; (iii) revenue growth greater than 20%; (iv) a market capitalization between approximately \$7 billion and \$25.0 billion; and (v) a market capitalization as a multiple of annual revenue that was greater than six. As a result of the application of these criteria, we removed the following companies from our 2016 compensation peer group: Aruba Networks, which was acquired, Informatica Corporation, which was taken private, and each of Ubiquiti Networks, Inc., Qlik Technologies, Inc., Aspen Technology, Inc. and SolarWinds, Inc. because they no longer met our revenue and/or market capitalization requirements and were not sufficiently relevant comparables. In addition, we added Akamai Technologies, Inc., Autodesk, Inc., Checkpoint Software, Inc. LinkedIn, Inc., Red Hat, Inc., Paychex, Inc., and VeriSign, Inc., which satisfied the above described criteria. The remainder of the peer group is unchanged.

The following publicly-traded companies made up our compensation peer group for the compensatory decisions made during fiscal 2017:

Akamai Technologies, Inc.	Fortinet Inc.	PayChex, Inc.
Arista Networks Inc.	LinkedIn, Inc.	Tableau Software, Inc.
Autodesk, Inc.	NetSuite Inc.	Splunk Inc.
Checkpoint Software, Inc.	Red Hat, Inc.	VeriSign, Inc.
F5 Networks Inc.	ServiceNow, Inc.	Workday, Inc.
FireEye, Inc.		

Compensia supplements the peer data with compensation data from surveys of similarly sized companies and uses this combination of market data to provide an analysis of compensation for executives holding positions comparable to the positions of our executives from the companies in our compensation peer group. Our compensation committee uses the market data as one reference point in determining the compensation of our executives. While our compensation committee focuses on compensation at or above the 50<sup>th</sup> percentile, our committee considers other factors in setting actual compensation. Such factors include the overall competitive market for our executives, the alignment between the market based positions and the actual responsibilities of our executives, each executive's performance, internal parity, the value of each executive's position and the value of each executive's unvested equity holdings.

### **Fiscal 2017 Executive Compensation Program Components**

The following describes each component of our executive compensation program, the rationale for each, and how the compensation amounts and awards were determined for fiscal 2017.

#### ***Base Salary.***

Base salary is the primary fixed component of our executive compensation program. We use base salary to compensate our NEOs for services rendered during the fiscal year and to ensure that we remain competitive in attracting and retaining executive talent. Generally, we establish the initial base salaries of our executive officers through arm's-length negotiation at the time we hire the individual executive officer, taking into account his or her position, qualifications, experience, prior salary level, and the base salaries of our other executive officers.

Thereafter, our compensation committee reviews the base salaries of each NEO annually and makes adjustments as it determines to be reasonable and necessary to reflect the scope of a NEO's performance, contributions, responsibilities, experience, current salary level, position (in the case of a promotion), and market positioning, as appropriate.

In October 2016, in connection with its review of our executive compensation program, our compensation committee approved adjustments to the base salary of our NEOs to be effective November 1, 2016. Based on an analysis prepared by Compensia, the then-current base salary level for each NEO (other than Mr. Anderson) was generally at or below the 50th percentile for the comparable executive in our compensation peer group. To move the target total cash compensation opportunity towards the 50th to the 75th percentile of the competitive market (as reflected by our compensation peer group) and to reward each individuals outstanding performance, our compensation committee approved base salary increases for each NEO, as set forth below.

<u>Named Executive Officer</u>	<u>Base Salary at End of Fiscal 2016 (\$)</u>	<u>Base Salary Effective November 1, 2016 (\$)</u>	<u>Percentage Increase</u>
Mr. McLaughlin . . . . .	600,000	750,000	25%
Mr. Tomlinson . . . . .	400,000	475,000	18.8%
Mr. Zuk . . . . .	400,000	415,000	3.8%
Mr. Bonvanie . . . . .	350,000	365,000	4.3%
Mr. Anderson . . . . .	700,000	740,000	5.7%

The relatively larger increases for Mr. McLaughlin and Mr. Tomlinson reflect (x) existing base salaries that were on the lower end with respect to our compensation peer group, (y) the significance of their responsibilities expected in fiscal 2017 and beyond and (z) their strong performance that warranted more competitive base salary relative to our compensation peer group.

The total base salaries of our NEOs paid for fiscal 2017, are set forth in the “Fiscal 2017 Summary Compensation Table” below.

### ***Short-Term Cash Incentive Compensation***

We use short-term cash incentive compensation to motivate our NEOs to achieve our annual financial and operational objectives, while making progress towards our longer-term strategic and growth goals. Typically, near the beginning of each fiscal year, our compensation committee adopts an incentive compensation plan for that fiscal year, which identifies the plan participants and establishes the target annual incentive compensation opportunity for each participant, the performance measures to be used to determine whether to make payouts for the fiscal year and the associated target levels for each measure, and the potential payouts based on actual performance for the fiscal year. Typically, cash incentive compensation payouts have been determined after the end of the applicable performance period based on our performance against one or more financial and/or operational performance objectives for the performance period as set forth in our annual operating plan.

*Fiscal 2017 Incentive Compensation Plan.* In October 2016, our compensation committee adopted and approved a sub-plan under our omnibus Employee Incentive Compensation Plan for fiscal 2017 (the “Fiscal 2017 Incentive Compensation Plan”). The Fiscal 2017 Incentive Compensation Plan provided for potential performance-based incentive payouts to all employees not paid commissions, including our NEOs. Further, the Fiscal 2017 Incentive Compensation Plan provided opportunities for cash incentive compensation payouts based on our actual achievement of pre-established corporate financial objectives as set forth in our annual operating plan. The target levels for the financial objectives in our annual operating plan were set at levels determined to be challenging and requiring substantial skill and effort on the part of senior management. The Fiscal 2017 Incentive Compensation Plan included quarterly performance periods with semi-annual payouts, including a potential accelerator and discretionary over-performance pool payable at the end of the year.

*Target Annual Incentive Compensation Opportunities.* As in prior years, the target annual incentive compensation opportunities for our NEOs were expressed as a percentage of their respective base salaries. In October 2016, in connection with its review of our fiscal 2017 executive compensation program, our compensation committee decided to maintain the percentage for all NEOs' target annual incentive compensation opportunities. However, due to the base salary increases described above, the dollar amount of the target annual incentive compensation opportunities increased for each of our NEOs. These base salary adjustments were generally intended so that the total target cash compensation opportunity for each NEO would be at or around the 50th to the 75th percentile of the competitive market (as reflected by our compensation peer group). For clarity, the adjustments approved in October 2016 were effective as of the second quarter of fiscal 2017 and the target annual incentive compensation opportunities for the first quarter of fiscal 2017 were the same as those at the end of fiscal 2016. The target annual incentive compensation opportunities established under the Fiscal 2017 Incentive Compensation Plan for our NEOs were:

<u>Named Executive Officer</u>	<u>Target Annual Incentive Compensation Opportunity (as a % of base salary) at end of Fiscal 2016</u>	<u>Target Annual Incentive Compensation Opportunity (as a % of base salary) effective as of 2nd quarter Fiscal 2017</u>	<u>Fiscal 2017 Target Annual Incentive Compensation Opportunity (\$)*</u>
Mr. McLaughlin . . . . .	110%	110%	783,750
Mr. Tomlinson . . . . .	60%	60%	273,750
Mr. Zuk . . . . .	50%	50%	205,625
Mr. Bonvanie . . . . .	50%	50%	180,625
Mr. Anderson . . . . .	60%	60%	438,000

\* The aggregate target annual incentive compensation opportunity for fiscal 2017, was determined with the first fiscal quarter target calculated based on the target annual incentive compensation opportunity in effect prior to the October 2016 adjustment, and the remaining three fiscal quarters calculated based on the target annual incentive compensation opportunity as adjusted for the base salary increases approved in October 2016.

*Corporate Performance Measures.* For purposes of funding the Fiscal 2017 Incentive Compensation Plan, our compensation committee selected revenue and earnings per share as the corporate performance measures. Our compensation committee chose revenue as a performance measure because we are currently focused on growing our business and revenue is a key metric during this stage of our growth and enhances long-term value creation for our stockholders. Our compensation committee chose earnings per share as a performance measure because it is an important profitability measure tied to management performance and how much profit we are generating for our stockholders. In order to receive a payout under the Fiscal 2017 Annual Incentive Compensation Plan both corporate performance measures needed to meet minimum pre-established achievement levels for the relevant performance period. For purposes of the Fiscal 2017 Incentive Compensation Plan, (x) "revenue" was defined as GAAP revenue as reflected in our quarterly and annual financial statements, consistent with our annual operating plan; and (y) "earnings per share" was defined as non-GAAP net income per share as reflected in our quarterly earnings press releases furnished to the SEC, adjusted to exclude the effects of incentives paid out under our Fiscal 2017 Incentive Compensation Plan. We also exclude the foreign currency gains (losses) and tax effects associated with these items in order to provide a complete picture of our recurring core business operating results.

*Performance Requirements.* Our NEOs were eligible for semi-annual incentive compensation payouts only to the extent, and in the amount, that we exceeded 97% of the applicable quarter's revenue target for fiscal 2017 and 88% of the applicable fiscal quarter's earnings per share target for fiscal 2017, each as set forth in the Fiscal 2017 Incentive Compensation Plan. By the formula in the Fiscal 2017 Incentive Compensation Plan,



achievement of 100% of both performance targets would have paid out at 100%. With respect to achievement in excess of 100%, such performance could be rewarded at the end of the fiscal year using an accelerator and/or a discretionary over-performance pool that would be funded at 200% of each NEO's applicable target annual incentive compensation opportunity, less any accelerator. If the over-performance pool was funded, our compensation committee could use its discretion to adjust down the actual cash incentive compensation payout. To inform its decision whether to exercise discretion under the Fiscal 2017 Incentive Compensation Plan, our compensation committee would have considered metrics in our annual operating plan other than revenue or earnings per share to balance the focus of our short-term incentive compensation program.

For fiscal 2017, our revenue increased by \$383.1 million to \$1.8 billion compared to fiscal 2016 and our non-GAAP earnings per share increased by \$0.82 per share compared to fiscal 2016. However, these results did not meet the significant stretch target levels our compensation committee established at the beginning of fiscal 2017. Because we did not achieve our desired revenue and earnings per share goals in fiscal 2017, we did not make any payouts to our NEOs under our Fiscal 2017 Incentive Compensation Plan.

### *Equity Compensation*

Following our initial public offering, through fiscal 2015, we primarily granted equity awards to our NEOs in the form of RSUs. Beginning in fiscal 2016, our compensation committee determined to grant equity awards to our NEOs solely in the form of restricted stock awards for shares of our common stock. Our compensation committee made this decision in part based on the fact that restricted stock awards would provide value even if the market price of our common stock fluctuated in the future. In addition, our compensation committee took into consideration the potential dilutive effect of these awards, noting that restricted stock awards require delivering fewer shares to provide equivalent value as a stock option.

While restricted stock units and restricted stock are generally economically equivalent, restricted stock awards are eligible for a greater tax deduction to us under Section 162(m) of the Code. As a result of this better tax qualification without the loss of economic benefit to the NEO or other adverse impact on us, we shifted from restricted stock units to restricted stock in fiscal 2016.

For fiscal 2017, as mentioned above, the most significant change to our fiscal 2017 compensation program is our inaugural grants of performance-based stock awards ("PSAs"). In October 2016, our compensation committee granted RSAs and PSAs to each of our NEOs after reviewing the equity compensation for our NEOs to assess whether each NEO was properly incentivized and rewarded. This was done in consultation with Compensia. The fiscal 2017 equity awards consist of 50% RSAs and 50% PSAs.

For the PSAs, the target number of shares set forth in the table below represents the number of shares eligible to be earned and subsequently vest upon achievement of the target performance on the billings metric for fiscal 2017. For purposes of the PSA target billings metric, "billings" was defined as total revenue plus the change in total deferred revenue, net of acquired deferred revenue, during fiscal 2017, and further adjusted to exclude post acquisition related billings. The PSAs reflect our compensation committee's commitment to incorporating performance measures into our long-term equity incentive program. The actual number of PSAs earned and eligible to vest was determined after the one-year performance period, based on achievement of the pre-established billings target in fiscal 2017. Our compensation committee believed that setting a one-year performance measurement period for PSAs was appropriate in fiscal 2017 due to our growth and our historical financial outperformance. The PSAs that satisfied the target billings performance measure set forth in the table below vest on the same vesting schedule as the fiscal 2017 RSAs awarded to such executive, also noted below, with vesting heavily weighted towards the latter portion of the service period to promote long-term incentives through the entire service period. Our compensation committee also believes that a time-based vesting schedule for any earned PSAs is important to provide additional long-term incentives for our highly valuable executives. Under this approach, while the threshold performance-period was one year, the imposition of a three-year additional time-vesting period was a way to balance the difficulty of setting multi-year performance goals while providing a longer-term incentive with back-end loaded vesting schedules.

Additionally, the number of PSAs that would be eligible for time-based vesting is determined as follows: (i) if we achieve 90% of the billings target then 50% of the PSAs are eligible for vesting, (ii) if we achieve 100% of the billings target then 100% of the PSAs are eligible for vesting, and (iii) if we achieve 110% of the billings target then 120% of the PSAs are eligible for vesting. If we achieve less than 90% of the billings target, then all of the PSAs forfeit. If performance is between the applicable tiers described above, then the payout of PSAs eligible for vesting scales linearly. In fiscal 2017, we achieved \$2,292.7 million in billings. In accordance with the payout attainment scale under the fiscal 2017 PSAs, our compensation committee determined that 91% of the billings metric payout was achieved, resulting in 55% of each NEO's target PSA being earned.

The RSA grants approved by our compensation committee are set forth in the table below. Our compensation committee determined that the RSAs should vest over four years and would be heavily weighted towards the latter three years (in the case of Mr. McLaughlin only vest during the last two years) of the service period to promote greater long-term incentives. Specifically:

- (1) With respect to Mr. McLaughlin's equity award, twenty-five percent of the shares subject to such award would vest on the two year anniversary of the grant date, and the remaining shares would vest in equal increments thereafter in the third and fourth years, subject to his continued employment with us. As a result of the vesting cliff, no shares vest prior to the two-year anniversary of the grant date.
- (2) With respect to Mr. Anderson's equity award, twelve percent of the shares subject to such award would vest on the one year anniversary of the grant date, twelve percent of the shares would vest in equal increments each quarter in the second year, and the remaining unvested shares would vest in equal quarterly amounts in the third and fourth years, subject to his continued employment with us.
- (3) With respect to Mr. Zuk's and Mr. Tomlinson's equity awards, one-eighth of the shares subject to such award would vest on the one year anniversary of the grant date, one-eighth of the shares subject to such award would vest quarterly in the second year, and the remaining unvested shares subject to such award would vest in equal quarterly in the third and fourth years, subject to their individual continued employment with the Company.
- (4) With respect to Mr. Bonvanie's equity award, one-sixth of the shares subject to such award would vest on the one year anniversary of the grant date, one-sixth of the shares subject to such award would vest quarterly in the second year, and the remaining unvested shares would vest in equal quarterly amounts over the third and fourth years, subject to his continued employment with the Company.

In determining the aggregate value of each NEO's fiscal 2017 equity award, our compensation committee considered the individual achievement of the NEO, as well as his expected future contributions, the skills, tenure and experience of the NEO, the recommendations of our CEO (except with respect to his own equity award), the competitive market data prepared by its compensation consultant, the value of his unvested equity holdings, internal pay parity, the dilutive effect of our long-term incentive compensation program and the overall impact that these equity awards would have on stockholder value.

Additionally, with respect to the aggregate value of Mr. McLaughlin's fiscal 2017 equity awards split between RSAs and PSAs and the determination to significantly back-end load the awards vesting schedules (i.e., no vesting prior to the two year anniversary of the grant date), our compensation committee considered (i) the value of Mr. McLaughlin's fiscal 2015 equity grant and his unvested equity position at the end of 2016, (ii) the value of his fiscal 2016 RSA valued at approximately \$5.8 million on the date of grant that approximated the 50<sup>th</sup> percentile of the equity awards granted to the chief executive officers of the companies in our fiscal 2016 compensation peer group and (iii) projected steep decline in the remaining unvested value at the end of fiscal 2018. Accordingly, our compensation committee determined to grant Mr. McLaughlin RSAs and PSAs having an aggregate value of \$10.0 million on the date of grant that approximated the 75<sup>th</sup> percentile of the equity granted to the CEOs of companies in our fiscal 2017 compensation peer group, but which had a significantly back-end loaded vesting schedule such that the first vesting event for the awards would not occur until October 2018 (the second anniversary of the date of grant).

With respect to our other NEOs, our compensation committee considered the value of each executive's unvested equity position and the applicable data for a comparable executive in our compensation peer group and made grants at or around the 60<sup>th</sup> to 75<sup>th</sup> percentile in our compensation peer group; provided, that the aggregate grants to Mr. Anderson and Mr. Bonvanie were in excess of the 75<sup>th</sup> percentile because of (x) the significance of their responsibilities expected in fiscal 2017 and beyond and (y) their strong performance that warranted exceptional payout relative to our compensation peer group.

The chart below sets forth the number of RSAs, the target number of PSAs granted in October 2016 by our compensation committee and the number of PSAs that were earned as determined by our compensation committee, as follows:

<u>Named Executive Officer</u>	<u>RSAs Granted in October 2016 (number of shares)</u>	<u>PSAs Granted in October 2016 (number of shares)</u>	<u>Earned PSAs (number of shares)</u>
Mr. McLaughlin . . . . .	32,402	32,402	17,707
Mr. Tomlinson . . . . .	12,960	12,960	7,082
Mr. Zuk . . . . .	12,960	12,960	7,082
Mr. Bonvanie . . . . .	9,720	9,720	5,311
Mr. Anderson . . . . .	19,441	19,441	10,624

The equity awards granted to our NEOs during the fiscal year ended July 31, 2017, are set forth in the “Fiscal 2017 Summary Compensation Table” and the “Fiscal 2017 Grants of Plan-Based Awards Table” below.

*Welfare and Other Employee Benefits.* We have established a tax-qualified Section 401(k) retirement plan for all employees who satisfy certain eligibility requirements, including requirements relating to age and length of service. As of January 1, 2016, we match contributions made to the plan by our employees up to \$1,000, including our NEOs. Messrs. Tomlinson, Anderson and Bonvanie participate in our Section 401(k) retirement plan. We intend for the plan to qualify under Section 401(a) of the Internal Revenue Code, or the Code, so that contributions by employees to the plan, and income earned on plan contributions, are not taxable to employees until withdrawn from the plan.

In addition, we provide other benefits to our NEOs on the same basis as all of our full-time employees in the country in which they are resident. These benefits include medical, dental, and vision benefits, medical and dependent care flexible spending accounts, short-term and long-term disability insurance, accidental death and dismemberment insurance, and basic life insurance coverage. We design our employee benefits programs to be affordable and competitive in relation to the market, as well as compliant with applicable laws and practices. We adjust our employee benefits programs as needed based upon regular monitoring of applicable laws and practices and the competitive market.

*Perquisites and Other Personal Benefits.* In fiscal 2017, we provided limited perquisites to Messrs. Anderson, McLaughlin and Zuk. We provided each with spousal travel and expenses to an annual vacation award for top sales performers, which we grossed-up for taxes.

In the future, we may provide perquisites or other personal benefits in limited circumstances, such as where we believe it is appropriate to assist an individual NEO in the performance of his or her duties, to make our NEOs more efficient and effective, and for recruitment, motivation, or retention purposes. All future practices with respect to perquisites or other personal benefits will be approved and subject to periodic review by our compensation committee.

### **Employment Agreements**

While we have not historically entered into employment agreements with our NEOs, the initial terms and conditions of employment of each of the NEOs (other than Mr. Zuk) were set forth in a written employment offer

letter. Each of these arrangements was approved by our Board of Directors or, in certain instances, our compensation committee. Each of these employment offer letters provided for “at will” employment and set forth the initial compensation arrangements for the NEO, including an initial base salary, an annual incentive compensation opportunity, and an equity award in the form of an option to purchase shares of our common stock. We believe that these employment offer letters were necessary to induce these individuals to forego other employment opportunities or leave their current employer for the uncertainty of a demanding position in a new and unfamiliar organization.

In December 2011, we entered into new confirmatory employment agreements and/or amendments with Messrs. McLaughlin, Zuk and Bonvanie to achieve consistency in the employment terms among our NEOs. For a summary of the material terms and conditions of these employment arrangements, see the section titled “—Executive Employment Agreements.”

### **Post-Employment Compensation**

The new confirmatory employment agreements with our NEOs provide each of them with protections in the event of their involuntary termination of employment following a change in control of us, and, in the case of Messrs. McLaughlin, Tomlinson and Anderson, their involuntary termination of employment not involving a change in control transaction. We believe that these protections assist us in retaining these individuals. We also believe that these protections serve our executive retention objectives by helping our NEOs maintain continued focus and dedication to their responsibilities to maximize stockholder value, including in the event that there is a potential transaction that could involve a change in control of us. The terms of these agreements were determined after our board of directors and compensation committee reviewed our retention goals for each NEO and an analysis of relevant market data.

For a summary of the material terms and conditions of these post-employment compensation arrangements, see the sections titled “—Executive Employment Agreements” and “—Potential Payments Upon Termination or Change in Control.”

### **Other Compensation Policies**

#### *Stock Ownership and Compensation Recovery Policies*

Our Board of Directors believes that our executive officers and the non-employee members of our Board of Directors should hold a meaningful financial stake in the company to closely align their interests with those of our stockholders and therefore adopted stock ownership guidelines in fiscal 2017. Under these guidelines, our CEO and executive officers who report directly to our CEO are required to achieve ownership of our common stock within five years of the later of August 26, 2016 or such executive officer’s hire, appointment or election date as applicable, at the following levels:

- Our CEO must own the lesser of (i) common stock with a value of five times his or her annual base salary or (ii) 22,000 shares; and
- Each executive officer must own the lesser of (i) common stock with a value of his or her annual base salary or (ii) 3,825 shares.

The base salary multiples above are consistent with current market practices, and the alternative share number thresholds are intended to provide our executive officers with certainty as to whether the guidelines are met, regardless of our then-current stock price.

After year end and during fiscal 2018, we adopted a Clawback Policy pursuant to which we may seek the recovery of performance-based incentive compensation paid by us. The Clawback Policy applies to our CEO and to all officers who report directly to the CEO, including our NEOs. The Clawback Policy provides that if (i) we

restate our financial statements as a result of a material error; (ii) the amount of cash incentive compensation or performance-based equity compensation that was paid or is payable based on achievement of specific financial results paid to a participant would have been less if the financial statements had been correct; (iii) no more than two years have elapsed since the original filing date of the financial statements upon which the incentive compensation was determined; and (iv) our compensation committee unanimously concludes, in its sole discretion, that fraud or intentional misconduct by such participant caused the material error and it would be in our best interests to seek from such participant recovery of the excess compensation, then our compensation committee may, in its sole discretion, seek repayment from such participant.

#### *Hedging and Pledging Policies*

Our insider trading policy prohibits our executive officers and members of our board of directors from engaging in derivative securities transactions, including hedging, with respect to our common stock and from pledging company securities as collateral or holding company securities in a margin account.

#### **Risk Assessment and Compensation Practices**

Our management assesses and discusses with our compensation committee our compensation policies and practices for our employees as they relate to our risk management, and based upon this assessment, we believe that, for the following reasons, any risks arising from such policies and practices are not reasonably likely to have a material adverse effect on us in the future:

- our incentive compensation plan reflects a pay for performance philosophy that rewards NEOs and other eligible employees for achievement of performance targets, and historically, we reserve the payment of discretionary bonuses for extraordinary performance and achievement;
- our equity awards include multi-year vesting schedules requiring long-term employee commitment;
- we regularly monitor short- and long-term compensation practices to determine whether management's objectives are satisfied; and
- for our Fiscal 2017 Incentive Compensation Plan, we instituted a per person cap of 300% of the target incentive compensation opportunity for each quarter to manage costs and to limit any potential risks related to short-term incentives.

#### **Tax and Accounting Considerations**

*Deductibility of Executive Compensation.* Section 162(m) of the Code generally disallows public companies a tax deduction for federal income tax purposes of remuneration in excess of \$1 million paid to the chief executive officer and each of the three other most highly compensated executive officers (other than the chief financial officer) in any taxable year. Generally, remuneration in excess of \$1 million may only be deducted if it is "performance-based compensation" within the meaning of the Code. Our compensation committee may consider the deductibility of compensation when making decisions, but will authorize the payment of compensation that is not deductible when it believes it appropriate.

*Taxation of "Parachute" Payments.* Sections 280G and 4999 of the Code provide that executive officers and directors who hold significant equity interests and certain other service providers may be subject to significant additional taxes if they receive payments or benefits in connection with a change in control that exceeds certain prescribed limits and that we (or a successor) may forfeit a deduction on the amounts subject to this additional tax. We did not provide any of our NEOs with a "gross-up" or other reimbursement payment for any tax liability that the NEO might owe as a result of the application of Sections 280G or 4999 during fiscal 2017, and we have not agreed and are not otherwise obligated to provide any NEO with such a "gross-up" or other reimbursement.

*Accounting for Share-Based Compensation.* We follow ASC Topic 718 for our share-based compensation awards. ASC Topic 718 requires companies to measure the compensation expense for all share-based compensation awards made to employees and directors, including stock options, based on the grant date “fair value” of these awards. This calculation is performed for accounting purposes and reported in the compensation tables below, even though our NEOs may never realize any value from their awards. ASC Topic 718 also requires companies to recognize the compensation cost of their share-based compensation awards in their income statements over the period that an executive officer is required to render service in exchange for the option or other award.

### Report of the Compensation Committee

Our compensation committee has reviewed and discussed the Compensation Discussion and Analysis with management. Based on such review and discussion, our compensation committee has recommended to our Board of Directors that the Compensation Discussion and Analysis be included in this proxy statement.

Respectfully submitted by the members of the compensation committee of our board of directors:

Asheem Chandna (Chair)  
 Carl Eschenbach  
 James J. Goetz  
 Daniel J. Warmenhoven

### Fiscal 2017 Summary Compensation Table

The following table presents summary information regarding the compensation paid to, or earned by, our Named Executive Officers for our fiscal year ended July 31, 2017.

<u>Name and Principal Position</u>	<u>Year</u>	<u>Salary (\$)</u>	<u>Stock Awards (\$)(1)</u>	<u>Option Awards (\$)</u>	<u>Non-Equity Incentive Plan Compensation (\$)</u>	<u>All Other Compensation (\$)</u>	<u>Total (\$)</u>
Mark D. McLaughlin (2) Chief Executive Officer	2017	712,500	9,625,986(3)	—	—	30,652(4)	10,369,138
	2016	575,000	5,799,986	—	302,288	1,734	6,679,009
	2015	487,500	65,424,000	—	692,750	2,466	66,606,716
Nir Zuk Chief Technology Officer	2017	411,250	3,850,157(3)	—	—	23,806(4)	4,285,213
	2016	387,500	31,739,384	—	93,684	—	32,220,568
	2015	337,500	8,275,481	—	222,125	—	8,835,106
Mark Anderson (5) President	2017	730,000	5,775,532(3)	—	—	25,066(6)	6,530,598
	2016	693,750	37,029,366	—	204,858	38,247	37,966,221
	2015	668,749	8,275,481	—	530,000	32,088	9,506,318
René Bonvanie Chief Marketing Officer	2017	361,250	2,887,618(3)	—	—	1,914(7)	3,250,782
	2016	337,500	12,695,719	—	81,193	—	13,114,413
	2015	353,749	6,206,556	—	192,625	—	6,752,930
Steffan C. Tomlinson Chief Financial Officer	2017	456,250	3,850,157(3)	—	—	1,914(7)	4,308,339
	2016	393,750	15,869,606	—	116,169	—	16,379,525
	2015	360,000	6,206,556	—	276,750	—	6,843,306

(1) The amounts reported in the Stock Awards column represent the grant date fair value of the restricted stock awards/units to purchase shares of our common stock granted to our Named Executive Officers as computed in accordance with ASC Topic 718. The assumptions used in calculating the grant date fair value of the restricted stock awards/units reported in this column are set forth in the notes to our audited consolidated financial statements included in our Annual Report on Form 10-K filed with the SEC on September 7, 2017. Note that the amounts reported in this column do not correspond to the actual economic value that may be received by our Named Executive Officers from their restricted stock unit awards or stock options.

- (2) Mr. McLaughlin served as President from July 2011 until August 2016 when Mr. Anderson was promoted to the position of President.
- (3) The amounts reported in the Stock Awards column for fiscal 2017 include awards that were granted 50% in time-based restricted stock awards and 50% in performance-based restricted stock awards. With respect to the performance-based restricted stock awards, the grant date fair value assumes achievement at 100% target level. Accordingly, 50% of the amounts reported represent the time-based restricted stock awards and 50% of the amounts reported represent performance-based stock awards. Assuming the highest level of the performance conditions is satisfied, the following are the values of the performance-based awards at the date of grant: Mr. McLaughlin, \$5,775,592; Mr. Zuk, \$2,310,094; Mr. Anderson, \$3,465,319; Mr. Bonvanie, \$1,732,571; and Mr. Tomlinson, \$2,310,094.
- (4) Represents travel expenses (including a gross-up for taxes) and life insurance payments.
- (5) Mr. Anderson served as Senior Vice President, Worldwide Field Operations from June 2012 to May 2016, as Executive Vice President, Worldwide Field Operations from May 2016 until August 2016, and as President since August 2016.
- (6) Represents travel expenses, including a gross-up for taxes, life insurance payments and a 401(k) plan matching contribution made by the Company.
- (7) Represents life insurance payments and a 401(k) plan matching contribution made by the Company.

### Fiscal 2017 Grants of Plan-Based Awards

The following table presents information regarding the amount of equity awards granted to our Named Executive Officers during our fiscal year ended July 31, 2017.

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards (1)			Estimated Future Payouts Under Equity Incentive Plan Awards (2)			All Other Stock Awards: Number of Shares of Stock or Units (#) (3)	All Other Option Awards: Number of Underlying Securities Options (#) (3)	Exercise or Base Price of Awards (\$/Share)	Grant Date Fair Value of Stock and Option Awards (\$) (4)
		Threshold (\$)	Target (\$)	Maximum (\$)	Threshold (#)	Target (#)	Maximum (#)				
Mr. McLaughlin . . .	—	—	783,750	2,351,250	—	—	—	—	—	—	—
	10/20/16	—	—	—	16,201	32,402	38,882	—	—	—	4,812,993
	10/20/16	—	—	—	—	—	—	32,402	—	—	4,812,993
Mr. Zuk . . . . .	—	—	205,625	616,875	—	—	—	—	—	—	—
	10/20/16	—	—	—	6,480	12,960	15,552	—	—	—	1,925,078
Mr. Anderson . . . .	—	—	438,000	1,314,000	—	—	—	—	—	—	—
	10/20/16	—	—	—	9,720	19,441	23,329	—	—	—	2,887,766
	10/20/16	—	—	—	—	—	—	19,441	—	—	2,887,766
Mr. Bonvanie . . . .	—	—	180,625	541,875	—	—	—	—	—	—	—
	10/20/16	—	—	—	4,860	9,720	11,664	—	—	—	1,443,809
Mr. Tomlinson . . . .	—	—	273,750	821,250	—	—	—	—	—	—	—
	10/20/16	—	—	—	6,480	12,960	15,552	9,720	—	—	1,443,809
	10/20/16	—	—	—	—	—	—	—	—	—	—
	10/20/16	—	—	—	6,480	12,960	15,552	—	—	—	1,925,078
	10/20/16	—	—	—	—	—	—	12,960	—	—	1,925,078

- (1) Amounts in the “Estimated Future Payouts Under Non-Equity Incentive Plan Awards” columns relate to target incentive compensation opportunities under the Fiscal 2017 Incentive Compensation Plan and assumes achievement at target levels for our corporate performance measures. For achievement in excess of target, overperformance could be rewarded with a payout of up to an additional 200% of each Named Executive Officer’s target (for a maximum payment of 300% each Named Executive Officer’s target). The actual amounts paid to our Named Executive Officers are set forth in the “Fiscal 2017 Summary Compensation Table” above and the calculation of the actual amounts paid is discussed more fully in the section titled “Executive Compensation—Executive Compensation Program Components.”
- (2) Represents performance-based stock awards which were granted under our Fiscal 2017 Incentive Compensation Plan. For more information, see the section titled “Discussion of our Fiscal 2017 Executive Compensation Program—Fiscal 2017 Executive Compensation Program Components—Equity Compensation”.

- (3) The restricted stock unit awards were made under the Palo Alto Networks, Inc. 2012 Equity Incentive Plan, or the 2012 Plan.
- (4) The amounts reported in the Grant Date Fair Value of Stock and Option Awards column represent the grant date fair value of the restricted stock unit awards granted in fiscal 2017, calculated in accordance with ASC Topic 718. The assumptions used in calculating the grant date fair value of the restricted stock unit awards reported in this column are set forth in the notes to our audited consolidated financial statements included in our Annual Report on Form 10-K filed with the SEC on September 7, 2017. Note that the amounts reported in this column do not correspond to the actual economic value that may be received by our Named Executive Officers from their restricted stock unit awards.

### Fiscal 2017 Outstanding Equity Awards at Fiscal Year-End

The following table presents information regarding outstanding stock options and other equity awards held by our Named Executive Officers as of July 31, 2017.

Named Executive Officer	Grant Date	Option Awards—Number of Securities Underlying Unexercised Options (#) Exercisable	Option Awards—Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Awards—Option Exercise Price (\$)	Option Awards—Option Expiration Date	Stock Awards—Number of Shares or Units of Stock That Have Not Vested (#)	Stock Awards—Market Value of Shares or Units of Stock That Have Not Vested (\$) (1)
Mr. McLaughlin . . . .	10/20/2016(2)	—	—	—	—	32,402	4,269,936
	10/20/2016(3)	—	—	—	—	32,402	4,269,936
	11/20/2015(4)	—	—	—	—	16,961	2,235,121
	11/20/2014(5)	—	—	—	—	150,000	19,767,000
	9/30/2011(6)	769,935	—	10.77	9/29/2021	—	—
Mr. Zuk . . . . .	10/20/2016(7)	—	—	—	—	12,960	1,707,869
	10/20/2016(8)	—	—	—	—	12,960	1,707,869
	11/20/2015(9)	—	—	—	—	123,761	16,309,225
	11/20/2014(10)	—	—	—	—	12,649	1,666,885
	01/21/2013(11)	15,000	—	55.36	1/21/2023	—	—
Mr. Anderson . . . . .	10/20/2016(12)	—	—	—	—	19,441	2,561,935
	10/20/2016(13)	—	—	—	—	19,441	2,561,935
	11/20/2015(14)	—	—	—	—	139,232	18,347,993
	11/20/2014(10)	—	—	—	—	14,230	1,875,229
	06/05/2012(15)	143,750	—	20.19	6/04/2022	—	—
Mr. Bonvanie . . . . .	10/20/2016(16)	—	—	—	—	9,720	1,280,902
	10/20/2016(17)	—	—	—	—	9,720	1,280,902
	11/20/2015(18)	—	—	—	—	43,317	5,708,314
	11/20/2014(10)	—	—	—	—	9,487	1,250,197
Mr. Tomlinson . . . . .	10/20/2016(7)	—	—	—	—	12,960	1,707,869
	10/20/2016(8)	—	—	—	—	12,960	1,707,869
	11/20/2015(4)	—	—	—	—	46,410	6,115,910
	11/20/2014(5)	—	—	—	—	9,487	1,250,197

- (1) The market value of unvested shares is calculated by multiplying the number of unvested shares held by the applicable Named Executive Officer by the closing market price of our common stock on the NYSE on July 31, 2017 (the last trading day of our fiscal year), which was \$131.78 per share.
- (2) This restricted stock award vests as to 25% of the shares on October 20, 2018; the remaining shares shall vest in equal increments each quarter thereafter with full vesting occurring on October 20, 2020.
- (3) This restricted stock award represents the target award amount. The Named Executive Officer may potentially earn from 0% to 120% of the target based on the achievement, if any, of the performance criteria at the end of the performance period. The actual award earned shall be determined upon certification by our compensation committee. If earned, shares would vest according to the vesting schedule set forth above in footnote (2).



- (4) This restricted stock award vests as to 1/3 of the shares covered by the award on November 20, 2016, with an additional 1/12 of the remaining shares subject to the award vesting quarterly thereafter with full vesting occurring on November 20, 2018.
- (5) This restricted stock unit award vests as to 1/3 of the shares covered by the award on March 1, 2016, with an additional 1/8 of the remaining shares subject to the award vesting quarterly thereafter with full vesting occurring on March 1, 2018.
- (6) This stock option vests monthly over four years with full vesting occurring on August 26, 2015.
- (7) This restricted stock award vests as to 1/8 of the shares on October 20, 2017; 1/8 of the shares shall vest in equal increments each quarter in the second year; and the remaining shares shall vest in equal increments each quarter thereafter with full vesting occurring on October 20, 2020.
- (8) This restricted stock award represents the target award amount. The Named Executive Officer may potentially earn from 0% to 120% of the target based on the achievement, if any, of the performance criteria at the end of the performance period. The actual award earned shall be determined upon certification by Company's Compensation Committee. If earned, shares would vest according to the vesting schedule set forth above in footnote (7).
- (9) This restricted stock award vests as to 1/6 of the shares covered by the award on November 20, 2016, with an additional 1/12 of the shares vesting quarterly in the year thereafter; and 1/8 of the shares vesting quarterly in the year thereafter with full vesting occurring on November 20, 2018.
- (10) This restricted stock unit award vests as to 1/3 of the shares covered by the award on November 20, 2015, with an additional 1/8 of the remaining shares subject to the award vesting quarterly thereafter with full vesting occurring on November 20, 2017.
- (11) This stock option vested as to 1/3 of the shares of common stock subject to the option on January 21, 2014, with an additional 1/8 of the remaining shares subject to the option vesting quarterly thereafter with full vesting occurring on January 21, 2016.
- (12) This restricted stock award vests as to 12% of the shares on October 20, 2017; 12% of the shares shall vest in equal increments each quarter in the second year; and the remaining shares shall vest in equal increments thereafter with full vesting occurring on October 20, 2020.
- (13) This restricted stock award represents the target award amount. The Named Executive Officer may potentially earn from 0% to 120% of the target based on the achievement, if any, of the performance criteria at the end of the performance period. The actual award earned shall be determined upon certification by Company's Compensation Committee. If earned, shares would vest according to the vesting schedule set forth above in footnote (12).
- (14) This restricted stock award vests as to 1/7 of the shares covered by the award on November 20, 2016, with the remaining shares vesting quarterly in equal increments over the next two years thereafter with full vesting on November 20, 2018.
- (15) This stock option vested as to 1/4 of the shares of common stock subject to the option on June 4, 2013, with an additional 1/36 of the remaining shares subject to the option vesting monthly thereafter with full vesting occurring on June 4, 2017.
- (16) This restricted stock award vests as to 1/6 of the shares on October 20, 2017; 1/6 of the shares shall vest in equal increments each quarter in the second year; and the remaining shares shall vest in equal increments each quarter thereafter with full vesting occurring on October 20, 2020.
- (17) This restricted stock award represents the target award amount. The Named Executive Officer may potentially earn from 0% to 120% of the target based on the achievement, if any, of the performance criteria at the end of the performance period. The actual award earned shall be determined upon certification by Company's Compensation Committee. If earned, shares would vest according to the vesting schedule set forth above in footnote (16).
- (18) This restricted stock award vests as to 1/4 of the shares covered by the award on November 20, 2016, with an additional 1/12 of the shares vesting quarterly in the year thereafter, and the remaining shares vesting quarterly thereafter with full vesting occurring on November 20, 2018.

## Fiscal 2017 Option Exercises and Stock Vested

The following table presents information regarding the exercise of stock options and the vesting of stock awards by our Named Executive Officers during our fiscal year ended July 31, 2017.

<u>Named Executive Officer</u>	<u>Option Awards— Number of Shares Acquired on Exercise (#)</u>	<u>Option Awards— Value Realized on Exercise (\$) (1)</u>	<u>Stock Awards— Number of Shares Acquired on Vesting (#)</u>	<u>Stock Awards— Value Realized on Vesting (\$) (2)</u>
Mr. McLaughlin . . . . .	70,000	9,193,800	233,630	31,118,843
Mr. Zuk . . . . .	—	—	103,846	15,092,854
Mr. Anderson . . . . .	—	—	114,145	16,489,527
Mr. Bonvanie . . . . .	4,417	440,391	66,580	9,677,730
Mr. Tomlinson . . . . .	—	—	73,717	10,942,681

- (1) Based on the market price of the Company's common stock on the date of exercise less the option exercise price paid for those shares, multiplied by the number of shares for which the option was exercised.
- (2) Based on the market price of the Company's common stock on the vesting date, multiplied by the number of shares vested.

## Pension Benefits

We did not sponsor any defined benefit pension or other actuarial plan for our Named Executive Officers during our fiscal year ended July 31, 2017.

## Nonqualified Deferred Compensation

We did not maintain any nonqualified defined contribution or other deferred compensation plans or arrangements for our Named Executive Officers during our fiscal year ended July 31, 2017.

## Executive Employment Agreements

We have entered into employment offer letters with each of our Named Executive Officers (other than Mr. Zuk) in connection with his commencement of employment with us.

Additionally, in December 2011, we entered into confirmatory new employment agreements with our then-serving executive officers and amended the employment offer letter of Mr. McLaughlin to achieve consistency in the employment terms and conditions of our executive officers.

Each of our Named Executive Officers is eligible to receive certain severance payments and benefits in connection with his termination of employment under various circumstances, including following a change in control, pursuant to written severance and change in control arrangements.

For a summary of the material terms and conditions of these arrangements, as well as an estimate of the potential payments and benefits payable to our Named Executive Officers under these arrangements, see the description below and the section titled “—Potential Payments Upon Termination or Change in Control” below. The estimated potential severance payments and benefits payable to each Named Executive Officer in the event of termination of employment as of July 31, 2017, pursuant to the arrangements under the confirmatory employment agreements, are described below.

The actual amounts that would be paid or distributed to our Named Executive Officers as a result of one of the termination events occurring in the future may be different than those presented below as many factors will affect the amount of any payments and benefits upon a termination of employment. For example, some of the factors that could affect the amounts payable include the Named Executive Officer's base salary and the market

price of our common stock. Although we have entered into written arrangements to provide severance payments and benefits to our Named Executive Officers in connection with a termination of employment under particular circumstances, we or an acquirer may mutually agree with the Named Executive Officers on severance terms that vary from those provided in these pre-existing arrangements. Finally, in addition to the amounts presented below, each Named Executive Officer would also be able to exercise any previously-vested stock options that he held. For more information about the Named Executive Officers outstanding equity awards as of July 31, 2017, see the section titled “—Fiscal 2017 Outstanding Equity Awards at Fiscal Year-End.”

Along with the severance payments and benefits described in a Named Executive Officer’s individual severance and change in control arrangement, they are eligible to receive any benefits accrued under our broad-based benefit plans, such as accrued vacation pay, in accordance with those plans and policies.

#### ***Termination of Employment Unrelated to a Change in Control***

*Messrs. McLaughlin, Tomlinson and Anderson.* In the event of an involuntary termination of employment (a termination of employment by us without “cause”), at any time before a “change in control” or more than 24 months following a “change in control,” provided that the executive officer executes an appropriate release and waiver of claims, Messrs. McLaughlin, Tomlinson and Anderson would be eligible to receive:

- continued payment of base salary as in effect as of the date of termination for a period of six months (or for Mr. McLaughlin, for a period of 12 months);
- a lump sum cash payment equal to the amount payable for premiums for continued COBRA benefits for a period of six months (or for Mr. McLaughlin, for a period of 12 months); and
- for Mr. McLaughlin only, accelerated vesting of the number of shares of our common stock underlying the stock option granted to him on September 30, 2011 that are then unvested equal to the number of shares that would have vested if he had remained employed for six months after the date of termination.

*Termination of Employment—Other Named Executive Officers.* None of the remaining Named Executive Officers are eligible to receive any specific payments or benefits in the event of an involuntary termination of employment unrelated to a change in control.

#### ***Termination of Employment in Connection with a Change in Control***

*Messrs. Zuk and Bonvanie.* In the event of an involuntary termination of employment (a termination of employment by us without “cause” or a termination of employment for “good reason”) within 12 months following a “change in control,” provided that the executive officer executes an appropriate release and waiver of claims, Messrs. Zuk and Bonvanie would each be eligible to receive:

- a lump sum cash payment equal to 12 months of his base salary as in effect as of the date of termination;
- a lump sum cash payment equal to 100% of his target incentive payment for that fiscal year;
- a lump sum cash payment equal to the amount payable for premiums for continued COBRA benefits for a period of 12 months; and
- accelerated vesting of the greater of (i) 12 months vesting of his then outstanding time-based equity awards, or (ii) 50% of his then outstanding, time-based equity awards.

*Messrs. McLaughlin, Tomlinson and Anderson.* In the event of an involuntary termination of employment (a termination of employment by us without “cause” or a termination of employment for “good reason”) within 24 months following a “change in control,” provided that the executive officer executes an appropriate release and waiver of claims, Messrs. McLaughlin, Tomlinson and Anderson would each be eligible to receive:

- a lump sum payment of his annual base salary as in effect as of the date of termination;

- a lump sum cash payment equal to 100% of his target incentive payment for that fiscal year;
- a lump sum cash payment equal to the amount payable for premiums for continued COBRA benefits for a period of 12 months; and
- 24 months of accelerated vesting of his then-outstanding, time-based equity awards.

*Applicable Definitions.* Generally, for purposes of the foregoing provisions, a “change in control” means:

- the sale or other disposition of all or substantially all of our assets;
- any sale or exchange of our capital stock by stockholders in a transaction or series of related transactions where more than 50% of the outstanding voting power of the company is acquired by a person or entity or group of related persons or entities;
- any reorganization, consolidation, or merger of the company where our outstanding voting securities immediately before the transaction represent or are converted into less than 50% of the outstanding voting power of the surviving entity (or its parent organization) immediately after the transaction; or
- the consummation of the acquisition of 51% or more of our outstanding stock pursuant to a tender offer validly made under any state or federal law (other than a tender offer by us).

Generally, for purposes of the foregoing provisions, “cause” is limited to:

- conviction of any felony or any crime involving moral turpitude or dishonesty;
- participation in intentional fraud or an act of willful dishonesty against us;
- willful breach of our policies that materially harms us;
- intentional damage of a substantial amount of our property;
- willful and material breach of the Named Executive Officer’s employment offer letter, employment agreement or his employee invention assignment and confidentiality agreement; or
- a willful failure or refusal in a material respect to follow the lawful, reasonable policies or directions of us as specified by our board of directors or Chief Executive Officer after being provided with notice of such failure, which failure is not remedied within 30 days after receipt of written notice from us.

Generally, for purposes of the foregoing provisions, “good reason” means a resignation within 12 months following the occurrence, without the Named Executive Officer’s written consent, of one or more of the following:

- there is a material reduction in the Named Executive Officer’s authority, status, obligations, or responsibilities, provided that, for Messrs. Zuk, Bonvanie and Anderson, following a “change in control,” a change in title alone will not constitute a material reduction;
- there is a reduction in the Named Executive Officer’s total annual compensation of more than 10% unless such reduction is no greater (in percentage terms) than compensation reductions imposed on substantially all of our employees pursuant to a directive of our board of directors;
- any failure by us to pay the Named Executive Officer’s base salary;
- the relocation of the principal place of our business to a location that is more than a specified number of miles further away from the Named Executive Officer’s home than our current location.

A resignation for “good reason” will not be deemed to have occurred unless the Named Executive Officer gives us written notice of one of the above conditions within 90 days of its occurrence, and we fail to remedy the condition within 30 days of receipt of such notice.

## Potential Payments Upon Termination or Change in Control

The tables below provide an estimate of the value of the compensation and benefits due to each of our Named Executive Officers for our fiscal year ended July 31, 2017, in the events described below, assuming that the termination of employment and change in control was effective on July 31, 2017, under the applicable employment agreements described above. The actual amounts to be paid can only be determined at the time of the termination of employment.

### *Termination of Employment Unrelated to a Change in Control*

Named Executive Officer	Salary Continuation (\$)	Value of Accelerated Equity Awards (\$) (1)		Value of Continued Health Care Coverage Premiums (\$)	Total (\$)
		Restricted Stock and Restricted Stock Units	Options		
Mr. McLaughlin	750,000	—	—	24,785	774,785
Mr. Tomlinson	237,500	—	—	12,392	249,829
Mr. Anderson	370,000	—	—	12,557	382,557

- (1) The amounts reported in the table reflect the aggregate market value of the unvested shares of our common stock underlying outstanding restricted stock awards, restricted stock unit awards, and stock options. For the unvested stock options, the aggregate market value is computed by multiplying (i) the number of shares of our common stock underlying unvested and outstanding stock options at July 31, 2017, that would become vested by (ii) the difference between \$131.78 (the closing market price of our common stock on the NYSE on July 31, 2017, the last trading day in the fiscal year ended July 31, 2017) and the exercise price of such option. For the restricted stock awards and the restricted stock unit awards, the aggregate market value is computed by multiplying (i) the number of unvested shares of our common stock subject to outstanding restricted stock awards or outstanding restricted stock unit awards at July 31, 2017, that would become vested by (ii) \$131.78 (the closing market price of our common stock on the NYSE on July 31, 2017, the last trading day in the fiscal year ended July 31, 2017).

### *Termination of Employment in Connection with a Change in Control*

Named Executive Officer	Salary Continuation (\$)	Target Annual Cash Bonus (\$)	Value of Accelerated Equity Awards (\$) (1)		Value of Continued Health Care Coverage Premiums (\$)	Total (\$)
			Restricted Stock and Restricted Stock Units	Options		
Mr. McLaughlin	750,000	825,000	25,338,000	—	24,785	26,937,785
Mr. Zuk	415,000	207,500	12,607,393	—	25,115	13,255,008
Mr. Bonvanie	365,000	182,500	5,774,204	—	24,785	6,346,489
Mr. Tomlinson	475,000	285,000	9,180,717	—	24,785	9,965,502
Mr. Anderson	740,000	444,000	22,913,116	—	25,115	24,122,231

- (1) The amounts reported in the table reflect the aggregate market value of the unvested shares of our common stock underlying outstanding restricted stock awards, restricted stock unit awards and stock options. For the unvested stock options, the aggregate market value is computed by multiplying (i) the number of shares of our common stock underlying unvested and outstanding stock options at July 31, 2017, that would become vested by (ii) the difference between \$131.78 (the closing market price of our common stock on the NYSE on July 31, 2017, the last trading day in the fiscal year ended July 31, 2017) and the exercise price of such option. For the restricted stock awards and the restricted stock unit awards, the aggregate market value is computed by multiplying (i) the number of unvested shares of our common stock subject to outstanding

restricted stock awards or restricted stock unit awards at July 31, 2017 that would become vested by (ii) \$131.78 (the closing market price of our common stock on the NYSE on July 31, 2017, the last trading day in the fiscal year ended July 31, 2017).

### Equity Compensation Plan Information

The following table provides information as of July 31, 2017, with respect to the shares of our common stock that may be issued under our existing equity compensation plans.

<u>Plan Category</u>	<u>(a) Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights</u>	<u>(b) Weighted Average Exercise Price of Outstanding Options, Warrants and Rights (\$) (2)</u>	<u>(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))</u>
Equity compensation plans approved by stockholders (1) .....	8,087,320	\$13.11	11,792,688
Equity compensation plans not approved by stockholders .....	—	—	—
Total .....	<u>8,087,320</u>		<u>11,792,688</u>

- (1) Includes the following plans: the 2012 Plan, 2005 Equity Incentive Plan and 2012 Employee Stock Purchase Plan (“2012 ESPP”). Our 2012 Plan provides that on the first day of each fiscal year commencing in fiscal year 2014, the number of shares authorized for issuance under the 2012 Plan is automatically increased by a number equal to the lesser of (i) 8,000,000 shares of common stock, (ii) four and one half percent (4.5%) of the aggregate number of shares of common stock outstanding on the last day of the preceding fiscal year, or (iii) such number of shares that may be determined by our board of directors. Our 2012 ESPP provides that on the first day of each fiscal year commencing in fiscal year 2014 the number of shares authorized for issuance under the 2012 ESPP is automatically increased by a number equal to the lesser of (i) 2,000,000 shares of common stock, (ii) one percent (1.0%) of the aggregate number of shares of common stock outstanding on such date, or (iii) an amount determined by our board of directors or a duly authorized committee of our board of directors.
- (2) The weighted average exercise price does not take into account outstanding restricted stock or RSUs, which have no exercise price.

## SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth certain information with respect to the beneficial ownership of our common stock as of September 30, 2017 for:

- each of our directors and nominees for director;
- each of our named executive officers;
- all of our current directors and executive officers as a group; and
- each person or group, who beneficially owned more than 5% of our common stock.

We have determined beneficial ownership in accordance with the rules and regulations of the SEC, and the information is not necessarily indicative of beneficial ownership for any other purpose. Except as indicated by the footnotes below, we believe, based on information furnished to us, that the persons and entities named in the table below have sole voting and sole investment power with respect to all shares of common stock that they beneficially owned, subject to applicable community property laws.

Applicable percentage ownership is based on 91,872,731 shares of our common stock outstanding at September 30, 2017. In computing the number of shares of common stock beneficially owned by a person and the percentage ownership of such person, we deemed to be outstanding all shares of common stock subject to options held by the person that are currently exercisable or exercisable (or issuable upon vesting of restricted stock units) within 60 days of September 30, 2017. However, we did not deem such shares outstanding for the purpose of computing the percentage ownership of any other person.

Unless otherwise indicated, the address of each beneficial owner listed in the table below is c/o Palo Alto Networks, Inc., 3000 Tannery Way, Santa Clara, California 95054. The information provided in the table below is based on our records, information filed with the SEC and information provided to us, except where otherwise noted.

	<b>Number of Shares</b>	<b>Percent of Shares Outstanding</b>
<b>5% Stockholders:</b>		
The Vanguard Group (1) . . . . .	7,262,069	7.9%
<b>Named Executive Officers and Directors:</b>		
Mark D. McLaughlin (2) . . . . .	1,077,709	1.2%
Nir Zuk (3) . . . . .	1,969,676	2.1%
Mark Anderson (4) . . . . .	307,740	*
Steffan C. Tomlinson (5) . . . . .	115,984	*
René Bonvanie (6) . . . . .	107,136	*
Lee Klarich (7) . . . . .	385,807	*
Frank Calderoni (8) . . . . .	5,169	*
Asheem Chandna (9) . . . . .	107,643	*
John M. Donovan (10) . . . . .	22,044	*
Carl Eschenbach (11) . . . . .	3,057	*
James J. Goetz (12) . . . . .	286,259	*
Mary Pat McCarthy (13) . . . . .	2,161	*
Stanley J. Meresman (14) . . . . .	14,924	*
Sridhar Ramaswamy (15) . . . . .	—	*
Daniel J. Warmenhoven (16) . . . . .	22,860	*
All current directors and executive officers as a group (15 Persons) (17) . . . . .	4,428,169	4.8%

\* Represents beneficial ownership of less than one percent (1%).

(1) As of June 30, 2017, the reporting date of The Vanguard Group's most recent filing with the SEC pursuant to Form 13F of the Exchange Act filed on August 24, 2017. The Vanguard Group has sole voting power

with respect to 71,644 shares and shared voting power with respect to 17,717 shares. The address for The Vanguard Group is P.O. Box 2600 V26, Valley Forge, PA 19482.

- (2) Consists of (i) 182,774 shares held of record by Mr. McLaughlin; (ii) 125,000 shares held of record by GRAT, for which Mr. McLaughlin serves as a trustee; and (iii) 769,935 shares issuable pursuant to stock options exercisable within 60 days of September 30, 2017.
- (3) Consists of (i) 1,653,375 shares held of record by Mr. Zuk; (ii) 294,976 shares held by the Zuk 2016 Grantor Retained Annuity Trust (GRAT) dated June 17, 2016, for which Mr. Zuk serves as a trustee; (iii) 15,000 shares issuable pursuant to stock options exercisable within 60 days of September 30, 2017; and (iv) 6,325 shares of common stock issuable upon the vesting of restricted stock units within 60 days of September 30, 2017.
- (4) Consists of (i) 156,875 shares held of record by Mr. Anderson; (ii) 143,750 shares issuable pursuant to stock options exercisable within 60 days of September 30, 2017; and (iii) 7,115 shares of common stock issuable upon the vesting of restricted stock units within 60 days of September 30, 2017.
- (5) Consists of (i) 111,240 shares held of record by Mr. Tomlinson; and (ii) 4,744 shares of common stock issuable upon the vesting of restricted stock units within 60 days of September 30, 2017.
- (6) Consists of (i) 102,392 shares held of record by Mr. Bonvanie; and (ii) 4,744 shares issuable upon the vesting of restricted stock units within 60 days of September 30, 2017.
- (7) Consists of 385,807 shares held of record by Mr. Klarich.
- (8) Consists of 5,169 shares held of record by Mr. Calderoni.
- (9) Consists of 104,032 shares held of record by the Chandna Family Revocable Trust DTD 4/13/98.
- (10) Consists of (i) 2,556 shares held of record by Mr. Donovan; and (ii) 19,488 shares held of record by SRJ Norway Partners LP, for which Mr. Donovan serves as the general partner.
- (11) Consists of 3,057 shares held of record by Mr. Eschenbach.
- (12) Consists of (i) 271,645 shares held of record by Mr. Goetz; and (ii) 14,614 shares held of record by the Goetz Children's Trust U/A 4/24/1998.
- (13) No shares were held by Ms. McCarthy as of September 30, 2017; and consists of 2,161 shares issuable upon the vesting of restricted stock units within 60 days of September 30, 2017.
- (14) Consists of 14,924 shares held of record by Mr. Meresman.
- (15) No shares were held by Mr. Ramaswamy as of September 30, 2017 and no equity awards vest within 60 days of September 30, 2017.
- (16) Consists of 22,860 shares held of record by Mr. Warmenhoven as Trustee of the Dan Warmenhoven Tr Ua 12/16/1987 The Warmenhoven 1987 Revocable Trust.
- (17) Consists of (i) 3,474,395 shares beneficially owned by the current directors and executive officers; (ii) 928,685 shares issuable pursuant to stock options exercisable within 60 days of September 30, 2017; and (iii) 25,089 shares of common stock issuable upon the vesting of restricted stock units within 60 days of September 30, 2017.



## RELATED PERSON TRANSACTIONS

We describe below transactions and series of similar transactions, since the beginning of our last fiscal year, to which we were a party or will be a party, in which:

- the amounts involved exceeded or will exceed \$120,000; and
- any of our directors, nominees for director, executive officers, or beneficial holders of more than 5% of any class of our outstanding capital stock had or will have a direct or indirect material interest.

Other than as described below, there has not been, nor is there any currently proposed, transactions or series of similar transactions to which we have been or will be a party.

### Employment Arrangements and Indemnification Agreements

We have entered into employment arrangements with certain current and former executive officers. See the section titled “Discussion of our Fiscal 2017 Executive Compensation Program—Executive Employment Agreements.”

We have also entered into indemnification agreements with our directors and executive officers. The indemnification agreements and our amended and restated certificate of incorporation and amended and restated bylaws require us to indemnify our directors and officers to the fullest extent permitted by Delaware law.

Monica Anderson, the daughter of Mark Anderson, our President, is employed by us as a Corporate Sales Representative. Her annual salary and other cash compensation is approximately \$107,754, and she receives benefits consistent with other employees serving in the same capacity. In addition, she received a grant of 194 RSUs during our fiscal year ended July 31, 2017.

### Transactions with AT&T Inc., Anaplan, Inc. and Google Inc.

Mr. Donovan, one of our independent directors, is an executive officer at AT&T. Since the beginning of our last fiscal year through October 15, 2017, both directly and through our channel partners, we have sold an aggregate of approximately \$58.8 million of products and services to AT&T and have purchased an aggregate of approximately \$0.2 million of AT&T products and services, all in arm’s length transactions. Mr. Calderoni, one of our independent directors, is an executive officer at Anaplan. Since the beginning of our last fiscal year through October 15, 2017, both directly and through our channel partners, we have sold an aggregate of approximately \$0.5 million of products and services to Anaplan and have purchased an aggregate of approximately \$0.7 million of Anaplan products and services, all in arm’s length transactions. Mr. Ramaswamy, one of our independent directors, is an executive at Google. Since the beginning of our last fiscal year through October 15, 2017, we have purchased an aggregate of approximately \$4.5 million of Google products and services, all in arm’s length transactions.

Additionally, none of Messrs. Donovan, Calderoni or Ramaswamy take part in the discussion of transactions with AT&T, Anaplan, or Google, respectively, when such transactions are reviewed by our board of directors. Additionally, AT&T expects its 2017 capital expenditures to be in the \$22 billion range. AT&T’s purchases of our products and services, which totaled \$58.8 million, are not material to either us or AT&T. All transactions with AT&T, Anaplan and Google are subject to our rigorous related party transactions review process and policy, as further described below.

### Policies and Procedures for Related Party Transactions

Our audit committee has the primary responsibility for reviewing and approving or ratifying transactions with related parties.

We have a formal written policy providing that our executive officers, directors, nominees for election as directors, beneficial owners of more than 5% of any class of our capital stock, any member of the immediate family of any of the foregoing persons, and any firm, corporation, or other entity in which any of the foregoing persons is employed, is a general partner or principal or in a similar position, or in which such person has a 5% or greater beneficial ownership interest, is not permitted to enter into a related party transaction with us without the consent of our audit committee, subject to the exceptions described below. In approving or rejecting any such proposal, our audit committee is to consider the relevant facts and circumstances available and deemed relevant to our audit committee, including, whether the transaction is on terms no less favorable than terms generally available to an unaffiliated third party under the same or similar circumstances, and the extent of the related party's interest in the transaction. Our audit committee has determined that certain transactions will not require audit committee approval, including certain employment arrangements of executive officers, director compensation, transactions with another company at which a related party's only relationship is as a non-executive employee, director or beneficial owner of less than 10% of that company's shares and the aggregate amount involved does not exceed the greater of \$500,000 or 2% of the company's total annual revenues, transactions where a related party's interest arises solely from the ownership of our common stock and all holders of our common stock received the same benefit on a pro rata basis, and transactions available to all employees generally.

## OTHER MATTERS

### Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires that our executive officers and directors, and persons who own more than 10% of our common stock, file reports of ownership and changes of ownership with the SEC. Such directors, executive officers and 10% stockholders are required by SEC regulation to furnish us with copies of all Section 16(a) forms they file.

SEC regulations require us to identify in this proxy statement anyone who filed a required report late during the most recent fiscal year. Based on our review of forms we received, or written representations from reporting persons stating that they were not required to file these forms, we believe that during our fiscal year ended July 31, 2017, all Section 16(a) filing requirements were satisfied on a timely basis.

### Fiscal Year 2017 Annual Report and SEC Filings

Our financial statements for our fiscal year ended July 31, 2017, are included in our Annual Report on Form 10-K, which we will make available to stockholders at the same time as this proxy statement. This proxy statement and our annual report are posted on our website at [www.paloaltonetworks.com](http://www.paloaltonetworks.com) and are available from the SEC at its website at [www.sec.gov](http://www.sec.gov). You may also obtain a copy of our annual report without charge by sending a written request to Investor Relations, Palo Alto Networks, Inc., 3000 Tannery Way, Santa Clara, California 95054.

\* \* \*

The board of directors does not know of any other matters to be presented at the Annual Meeting. If any additional matters are properly presented at the Annual Meeting, the persons named in the enclosed proxy card will have discretion to vote the shares of our common stock they represent in accordance with their own judgment on such matters.

It is important that your shares of our common stock be represented at the Annual Meeting, regardless of the number of shares that you hold. You are, therefore, urged to vote by telephone or by using the Internet as instructed on the enclosed proxy card or execute and return, at your earliest convenience, the enclosed proxy card in the envelope that has also been provided.

**THE BOARD OF DIRECTORS**

Santa Clara, California  
October 23, 2017

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**PALO ALTO NETWORKS, INC.  
EXECUTIVE INCENTIVE PLAN**

**PURPOSE**

The purpose of the Palo Alto Networks, Inc. Executive Incentive Plan (the “Plan”) is to motivate and reward eligible Service Providers of Palo Alto Networks, Inc. (the “Company”) for their service. It is the intent that the incentives provided for in the Plan to certain executive officers of the Company do not have their deductibility limited by Section 162(m). However, the Company cannot guarantee that awards under the Plan will qualify for exemption under Section 162(m), and in certain circumstances, Actual Cash Awards or Equity Awards under the Plan may not comply with Section 162(m), either intentionally or unintentionally. The Plan is subject to the approval of the Company’s stockholders.

The Plan is divided into three articles: Article I, which addresses the cash component of the Plan (the “Cash Component”); Article II, which addresses the equity component of the Plan (the “Equity Component”); and Article III, which sets forth (i) the terms and conditions that apply to both the Cash Component and the Equity Component and (ii) the defined terms used in the Plan. The Plan is effective upon the date of its approval by the Company’s stockholders (the “Effective Date”) as set forth above.

**ARTICLE I  
CASH COMPONENT**

1. Administration of the Cash Component.

- (a) General. The Cash Component will be administered by the Administrator.
- (b) Multiple Administrative Bodies. Different Committees with respect to different groups of Covered Employees may administer the Cash Component.
- (c) Powers of the Administrator. Subject to the Plan, any limitations on delegations and applicable laws, the Administrator will have the authority, in its sole discretion to make any determinations deemed necessary or advisable to administer the Cash Component including:
  - (i) to select the Cash Component Participants,
  - (ii) to establish the length of the Performance Periods,
  - (iii) to establish Performance Goals for performance during each Performance Period,
  - (iv) to determine the Payout Calculation Methodology for each Performance Goal, and
  - (v) to make all determinations and take all other actions necessary or appropriate for the proper administration and operation of the Cash Component.

Any determination by the Administrator on any matter relating to the Cash Component shall be made in its sole discretion and need not be uniform among Cash Component Participants. The Administrator’s interpretation of the Cash Component shall be final, conclusive, and binding on all parties concerned, including the Company, its stockholders, and any or all Cash Component Participants.

2. Eligibility. Actual Cash Awards under the Cash Component may be paid to any Cash Component Participant.

3. Actual Cash Awards.

(a) General. Actual Cash Awards may be payable to a Cash Component Participant because of the satisfaction of Performance Goals established with respect to a Performance Period. A Cash Component Participant may be eligible for Actual Cash Awards for multiple and overlapping Performance Periods.

(b) Setting Cash Award Criteria. No later than the Determination Date for a Performance Period (which must be a date on which the outcome of the applicable Payout Calculation Methodology is substantially uncertain), the Administrator will,

(i) designate one or more Cash Component Participants,

(ii) select the Performance Goals applicable to the Performance Period,

(iii) establish the Payout Calculation Methodology for such Performance Goals; and

(iv) establish a target award and Maximum Cash Award for each Cash Component Participant for the Performance Period.

(c) Performance Goals.

(i) If a Performance Goal is based on, or calculated with respect to, the Company's common stock (such as increases in earnings per share, book value per share or other similar measures), then, if any corporate transaction occurs involving the Company (including, without limitation, any subdivision or combination or exchange of the outstanding shares of common stock, stock dividend, stock split, spin-off, split-off, recapitalization, capital reorganization, liquidation, reclassification of shares of common stock, merger, consolidation, extraordinary cash distribution, redemption, stock issuance, or sale, lease or transfer of substantially all of the assets of the Company), the Administrator shall make or provide for such adjustments in such Performance Goal as the Administrator may in good faith determine to be equitably required to prevent dilution or enlargement of any increase or decrease in the rights of Cash Component Participants.

(ii) To the extent identified in the Payout Calculation Methodology, evaluation of performance may include or exclude events or items as specified by the Administrator including, without limitation, the following unusual or nonrecurring events: (i) asset write downs; (ii) litigation or claim judgments or settlements; (iii) the effect of changes in tax laws, accounting principles or other laws or provisions affecting reported results; (iv) any reorganization and restructuring programs; (v) extraordinary nonrecurring items as described in Financial Accounting Standards Board Accounting Standards Codification 225-20 "Extraordinary and Unusual Items" and/or in management's discussion and analysis of financial condition and results of operations appearing in the Company's Annual Report on Form 10-K for the applicable fiscal year; (vi) acquisitions or divestitures; and (vii) foreign exchange gains and losses.

(d) Actual Bonus Determination.

(i) Before any Actual Cash Award is paid, the Administrator must certify in writing (i) to what extent the Performance Goal(s) were attained and (ii) the result of the Payout Calculation Methodology for each Cash Component Participant based upon the attainment of the Performance Goal(s).

(ii) The Administrator may determine to pay a Cash Component Participant an Actual Cash Award up to the amount specified in the foregoing certification. The Administrator may also reduce or eliminate

the amount of any Actual Cash Award of any Cash Component Participant at any time prior to payment thereof, based on such criteria as it shall determine, including but not limited to individual merit and attainment of, or the failure to attain, specified personal goals established by the Administrator.

(iii) Under no circumstance may the Administrator, increase the amount of Actual Cash Award paid to a Cash Component Participant under the Cash Component above the amount determined in Section 3(d)(i) of the Cash Component based on the Payout Calculation Methodology.

(e) Payment. Following the Administrator's determination under Section 3(d) of the Cash Component, Actual Cash Awards shall be paid in cash as promptly as is administratively practicable.

(f) Death, Disability, Termination of Employment.

(i) If a Cash Component Participant dies or terminates employment due to Disability prior to the end of a Performance Period, the Cash Component Participant (or if the participant's death occurs, the Cash Component Participant's beneficiary) may receive a pro-rata portion of the target award established for the Cash Component Participant as determined by the Administrator.

(ii) If a Cash Component Participant's employment with the Company is otherwise terminated during the Performance Period, the Cash Component Participant will not have earned and will not be entitled to payment of any Actual Cash Award.

(g) Annual Maximum. The aggregate of all Actual Cash Awards payable to a Cash Component Participant under the Cash Component in any fiscal year of the Company may not exceed the Maximum Cash Award, and any excess will be forfeited.

#### 4. Other Terms.

(a) No Effect on Employment or Service. Neither the Cash Component nor any award under the Cash Component will confer upon a Cash Component Participant any right regarding continuing the Cash Component Participant's relationship as an employee of the Company or an Affiliate, nor will they interfere with the Cash Component Participant's right, or the Cash Component Participant's employer's right, to terminate such relationship with or without cause, to the extent permitted by applicable laws.

(b) Right to Actual Cash Award. No officer or other person shall have any claim or right to receive any Actual Cash Award payable under the Cash Component prior to the actual payment thereof, regardless of whether the Administrator has certified any amount to be payable to any Cash Component Participant.

(c) Taxes. The Company or any Affiliate employing a Cash Component Participant, as applicable, may deduct from all Actual Cash Awards payable any federal, state, local or foreign taxes required by law to be withheld regarding such payments.

(d) No Transfers or Assignments. No award under the Cash Component nor any rights or interests or shall be assigned, transferred, pledged, encumbered, or hypothecated to, or in favor of, or subject to any lien, obligation, or liability of a Cash Component Participant to, any party (other than the Company or any Affiliate).

(e) Non-exclusivity of Cash Component. Nothing in the Cash Component shall be construed as limiting the authority of the Administrator, the Board, the Company or any Affiliate to establish any other annual, long-term or other incentive plan or as limiting the authority of any of the foregoing to pay cash bonuses or other supplemental or additional incentive compensation to any persons employed by the Company or any Affiliate, whether or not such person is a Cash Component Participant in this Cash Component and regardless of how the amount of such bonus or compensation is determined.

(f) Section 409A. It is intended that all bonuses payable under this Cash Component will be exempt from the requirements of Section 409A under the “short-term deferral” exemption or will comply with the requirements of Section 409A so that none of the payments and benefits to be provided under this Cash Component will be subject to the additional tax imposed under Section 409A, and any ambiguities or ambiguous terms will be interpreted to so comply or be exempt. Each payment and benefit payable under this Cash Component is intended to constitute a separate payment for purposes of Section 1.409A-2(b)(2) of the Treasury Regulations. In no case will the Company or any Affiliate reimburse any Cash Component Participant for any tax liabilities incurred under Section 409A.

## ARTICLE II

### **EQUITY COMPONENT**

#### 1. Shares Issuable Under the Equity Component.

(a) Shares Subject to Equity Awards. The Shares underlying an Equity Award will be issued from the Equity Plan.

(b) Incentive Stock Options. Subject to adjustment as provided in Section 13 of the Equity Plan and/or Section 13 of the Equity Component, the maximum number of Shares that may be issued upon the exercise of Incentive Stock Options will equal 200% of the aggregate Share number stated in Section 3(a) of the Equity Plan, plus, to the extent allowable under Section 422 of the Code and the Treasury Regulations promulgated thereunder, any Shares that become available for issuance under the Equity Plan pursuant to Sections 3(b) and 3(c) of the Equity Plan.

#### 2. Administration of the Equity Component.

##### (a) Procedure.

(i) Generally. The Equity Component will be administered by the Administrator.

(ii) Multiple Administrative Bodies. Different Committees with respect to different groups of Service Providers may administer the Equity Component.

(iii) Rule 16b-3. To the extent desirable to qualify transactions hereunder as exempt under Rule 16b-3, the transactions contemplated hereunder will be structured to satisfy the requirements for exemption under Rule 16b-3.

(b) Powers of the Administrator. Subject to the provisions of the Plan, and in the case of a Committee, subject to the specific duties delegated by the Board to such Committee, the Administrator will have the authority, in its discretion:

(i) to determine the Fair Market Value;

(ii) to select the Service Providers to whom Equity Awards may be granted hereunder;

(iii) to determine the number of Shares to be covered by each Equity Award granted hereunder;

(iv) to approve forms of Equity Award Agreements for use under the Equity Component;

(v) to determine the terms and conditions, not inconsistent with the terms of the Equity Component, of any Equity Award granted hereunder. Such terms and conditions include, but are not limited to,



the exercise price, the time or times when Equity Awards may be exercised (which may be based on performance criteria), any vesting acceleration or waiver of forfeiture restrictions, and any restriction or limitation regarding any Equity Award or the Shares relating thereto, based in each case on such factors as the Administrator will determine;

(vi) to construe and interpret the terms of the Equity Component and Equity Awards granted pursuant to the Equity Component;

(vii) to prescribe, amend and rescind rules and regulations relating to the Equity Component, including rules and regulations relating to sub-plans established for the purpose of satisfying applicable foreign laws or for qualifying for favorable tax treatment under applicable foreign laws;

(viii) to modify or amend each Equity Award (subject to Section 3 of Article III), including but not limited to the discretionary authority to extend the post-termination exercisability period of Equity Awards and to extend the maximum term of an Option (subject to Section 5(b) of the Equity Component regarding Incentive Stock Options);

(ix) to allow Equity Component Participants to satisfy withholding tax obligations in such manner as prescribed in Section 14 of the Equity Component;

(x) to authorize any person to execute on behalf of the Company any instrument required to effect the grant of an Equity Award previously granted by the Administrator;

(xi) to allow an Equity Component Participant to defer the receipt of the payment of cash or the delivery of Shares that would otherwise be due to such Equity Component Participant under an Equity Award; and

(xii) to make all other determinations deemed necessary or advisable for administering the Equity Component.

(c) No Exchange Program. The Administrator may not implement an Exchange Program.

(d) Effect of Administrator's Decision. The Administrator's decisions, determinations, and interpretations will be final and binding on all Equity Component Participants and any other holders of Equity Awards.

3. Eligibility. Equity Awards may be granted only to Service Providers.

4. Equity Award Limitations.

(a) Annual Equity Awards for Employees. The limits specified below shall be applicable to Equity Awards issued under the Equity Component to Employees:

(i) Limits on Options. No Employee shall be granted Options during any Fiscal Year with respect to more than 500,000 Shares; provided, however, that in connection with an Equity Component Participant's initial service as an Employee, the Equity Component Participant may be granted Options with respect to an additional 500,000 Shares during such Fiscal Year.

(ii) Limits on Restricted Stock. No Employee shall be granted Equity Awards of Restricted Stock during any Fiscal Year with respect to more than 250,000 Shares; provided, however, that in connection with an Equity Component Participant's initial service as an Employee, the Equity Component Participant may be granted Equity Awards of Restricted Stock with respect to an additional 250,000 Shares during such Fiscal Year.

(iii) Limits on Restricted Stock Units. No Employee shall be granted Restricted Stock Units during any Fiscal Year with respect to more than 250,000 Shares; provided, however, that in connection with an Equity Component Participant's initial service as an Employee, the Equity Component Participant may be granted Restricted Stock Units with respect to an additional 250,000 Shares during such Fiscal Year.

(iv) Limits on Stock Appreciation Rights. No Employee shall be granted Stock Appreciation Rights during any Fiscal Year with respect to more than 500,000 Shares; provided, however, that in connection with an Equity Component Participant's initial service as an Employee, the Equity Component Participant may be granted Stock Appreciation Rights with respect to an additional 500,000 Shares during such Fiscal Year.

(v) Limits on Performance Shares. No Employee shall be granted Equity Awards of Performance Shares during any Fiscal Year with respect to more than 250,000 Shares; provided, however, that in connection with an Equity Component Participant's initial service as an Employee, the Equity Component Participant may be granted Equity Awards of Performance Shares with respect to an additional 250,000 Shares during such Fiscal Year.

(vi) Limits on Performance Units. No Employee shall be granted Equity Awards of Performance Units during any Fiscal Year with an aggregate initial value of greater than 250,000 Shares (or, in the case of any cash-settled Performance Units, the dollar value based on the product of 250,000 Shares *multiplied by* the Fair Market Value as of the day prior to the Effective Date); provided, however, that in connection with an Equity Component Participant's initial service as an Employee, the Equity Component Participant may be granted Equity Awards of Performance Shares with respect to an additional 250,000 Shares (or, in the case of any cash-settled Performance Units, the dollar value based on the product of 250,000 Shares *multiplied by* the Fair Market Value as of the day prior to the Effective Date) during such Fiscal Year.

(b) Annual Awards for Outside Directors. No Outside Director may, in any Fiscal Year, be paid, whether under the Plan or otherwise, cash compensation and granted equity awards (including, but not limited to, Equity Awards issued under the Equity Component) with an aggregate value (determined as fair value under GAAP with respect to equity awards) greater than \$2,000,000, except that such limit will be increased to \$4,000,000 in the Fiscal Year of his or her initial service as an Outside Director. Any cash compensation paid or equity awards granted to an individual for his or her services as an Employee, or for his or her services as a Consultant (other than as an Outside Director), will not count for purpose of this limitation.

## 5. Stock Options.

(a) Limitations. Each Option will be designated in the Equity Award Agreement as either an Incentive Stock Option or a Nonstatutory Stock Option. However, notwithstanding such designation, to the extent that the aggregate Fair Market Value of the Shares with respect to which Incentive Stock Options are exercisable for the first time by the Equity Component Participant during any calendar year (under all plans of the Company and any Parent or Subsidiary) exceeds \$100,000, such Options will be treated as Nonstatutory Stock Options. For purposes of this Section 5(a) of the Equity Component, Incentive Stock Options will be taken into account in the order in which they were granted. The Fair Market Value of the Shares will be determined as of the time the Option with respect to such Shares is granted.

(b) Term of Option. The term of each Option will be stated in the Equity Award Agreement. In the case of an Incentive Stock Option, the term will be 10 years from the date of grant or such shorter term as may be provided in the Equity Award Agreement. Moreover, in the case of an Incentive Stock Option granted to an Equity Component Participant who, at the time the Incentive Stock Option is granted, owns stock representing more than 10% of the total combined voting power of all classes of stock of the Company or any Parent or Subsidiary, the term of the Incentive Stock Option will be 5 years from the date of grant or such shorter term as may be provided in the Equity Award Agreement.

(c) Option Exercise Price and Consideration.

(i) Exercise Price. The per share exercise price for the Shares to be issued pursuant to exercise of an Option will be determined by the Administrator, subject to the following:

(1) In the case of an Incentive Stock Option

a) granted to an Employee who, at the time the Incentive Stock Option is granted, owns stock representing more than 10% of the voting power of all classes of stock of the Company or any Parent or Subsidiary, the per Share exercise price will be no less than 110% of the Fair Market Value per Share on the date of grant.

b) granted to any Employee other than an Employee described in paragraph (a) immediately above, the per Share exercise price will be no less than 100% of the Fair Market Value per Share on the date of grant.

(2) In the case of a Nonstatutory Stock Option, the per Share exercise price will be no less than 100% of the Fair Market Value per Share on the date of grant.

(3) Notwithstanding the foregoing, Options may be granted with a per Share exercise price of less than 100% of the Fair Market Value per Share on the date of grant pursuant to a transaction described in, and in a manner consistent with, Section 424(a) of the Code.

(ii) Waiting Period and Exercise Dates. At the time an Option is granted, the Administrator will fix the period within which the Option may be exercised and will determine any conditions that must be satisfied before the Option may be exercised.

(iii) Form of Consideration. The Administrator will determine the acceptable form of consideration for exercising an Option, including the method of payment. In the case of an Incentive Stock Option, the Administrator will determine the acceptable form of consideration at the time of grant. Such consideration may consist entirely of: (1) cash; (2) check; (3) promissory note, to the extent permitted by Applicable Laws, (4) other Shares, provided that such Shares have a Fair Market Value on the date of surrender equal to the aggregate exercise price of the Shares as to which such Option will be exercised and provided that accepting such Shares will not result in any adverse accounting consequences to the Company, as the Administrator determines in its sole discretion; (5) consideration received by the Company under a broker-assisted (or other) cashless exercise program (whether through a broker or otherwise) implemented by the Company in connection with the Equity Component; (6) by net exercise; (7) such other consideration and method of payment for the issuance of Shares to the extent permitted by Applicable Laws; or (8) any combination of the foregoing methods of payment.

(d) Exercise of Option.

(i) Procedure for Exercise; Rights as a Stockholder. Any Option granted hereunder will be exercisable according to the terms of the Equity Component and at such times and under such conditions as determined by the Administrator and set forth in the Equity Award Agreement. An Option may not be exercised for a fraction of a Share.

An Option will be deemed exercised when the Company receives: (i) notice of exercise (in such form as the Administrator may specify from time to time) from the person entitled to exercise the Option, and (ii) full payment for the Shares with respect to which the Option is exercised (together with applicable withholding taxes). Full payment may consist of any consideration and method of payment authorized by the Administrator and permitted by the Equity Award Agreement and the Equity Component. Shares issued upon exercise of an Option will be issued in the name of the Equity Component Participant or, if requested by the Equity Component Participant, in the name of the Equity Component Participant and his or her spouse. Until the

Shares are issued (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company), no right to vote or receive dividends or any other rights as a stockholder will exist with respect to the Shares subject to an Option, notwithstanding the exercise of the Option. The Company will issue (or cause to be issued) such Shares promptly after the Option is exercised. No adjustment will be made for a dividend or other right for which the record date is prior to the date the Shares are issued, except as provided in Section 13 of the Equity Plan and/or Section 13 of the Equity Component.

Exercising an Option in any manner will decrease the number of Shares thereafter available, both for purposes of the Equity Component and for sale under the Option, by the number of Shares as to which the Option is exercised.

(ii) Termination of Relationship as a Service Provider. If an Equity Component Participant ceases to be a Service Provider, other than upon the Equity Component Participant's termination as the result of the Equity Component Participant's death or Disability, the Equity Component Participant may exercise his or her Option within such period of time as is specified in the Equity Award Agreement to the extent that the Option is vested on the date of termination (but in no event later than the expiration of the term of such Option as set forth in the Equity Award Agreement). In the absence of a specified time in the Equity Award Agreement, the Option will remain exercisable for 3 months following the Equity Component Participant's termination. Unless otherwise provided by the Administrator, if on the date of termination the Equity Component Participant is not vested as to his or her entire Option, the Shares covered by the unvested portion of the Option will revert to the Equity Component. If after termination the Equity Component Participant does not exercise his or her Option within the time specified by the Administrator, the Option will terminate, and the Shares covered by such Option will revert to the Equity Component.

(iii) Disability of Equity Component Participant. If an Equity Component Participant ceases to be a Service Provider as a result of the Equity Component Participant's Disability, the Equity Component Participant may exercise his or her Option within such period of time as is specified in the Equity Award Agreement to the extent the Option is vested on the date of termination (but in no event later than the expiration of the term of such Option as set forth in the Equity Award Agreement). In the absence of a specified time in the Equity Award Agreement, the Option will remain exercisable for 12 months following the Equity Component Participant's termination. Unless otherwise provided by the Administrator, if on the date of termination the Equity Component Participant is not vested as to his or her entire Option, the Shares covered by the unvested portion of the Option will revert to the Equity Component. If after termination the Equity Component Participant does not exercise his or her Option within the time specified herein, the Option will terminate, and the Shares covered by such Option will revert to the Equity Component.

(iv) Death of Equity Component Participant. If an Equity Component Participant dies while a Service Provider, the Option may be exercised following the Equity Component Participant's death within such period of time as is specified in the Equity Award Agreement to the extent that the Option is vested on the date of death (but in no event may the option be exercised later than the expiration of the term of such Option as set forth in the Equity Award Agreement), by the Equity Component Participant's designated beneficiary, provided such beneficiary has been designated prior to Equity Component Participant's death in a form acceptable to the Administrator. If no such beneficiary has been designated by the Equity Component Participant, then such Option may be exercised by the personal representative of the Equity Component Participant's estate or by the person(s) to whom the Option is transferred pursuant to the Equity Component Participant's will or in accordance with the laws of descent and distribution. In the absence of a specified time in the Equity Award Agreement, the Option will remain exercisable for 12 months following Equity Component Participant's death. Unless otherwise provided by the Administrator, if at the time of death Equity Component Participant is not vested as to his or her entire Option, the Shares covered by the unvested portion of the Option will immediately revert to the Equity Component. If the Option is not so exercised within the time specified herein, the Option will terminate, and the Shares covered by such Option will revert to the Equity Component.

6. Restricted Stock.

(a) Grant of Restricted Stock. Subject to the terms and provisions of the Equity Component, the Administrator, at any time and from time to time, may grant Shares of Restricted Stock to Service Providers in such amounts as the Administrator, in its sole discretion, will determine.

(b) Restricted Stock Agreement. Each Equity Award of Restricted Stock will be evidenced by an Equity Award Agreement that will specify the Period of Restriction, the number of Shares granted, and such other terms and conditions as the Administrator, in its sole discretion, will determine. Unless the Administrator determines otherwise, the Company as escrow agent will hold Shares of Restricted Stock until the restrictions on such Shares have lapsed.

(c) Transferability. Except as provided in this Section 6 of the Equity Component or the Equity Award Agreement, Shares of Restricted Stock may not be sold, transferred, pledged, assigned, or otherwise alienated or hypothecated until the end of the applicable Period of Restriction.

(d) Other Restrictions. The Administrator, in its sole discretion, may impose such other restrictions on Shares of Restricted Stock as it may deem advisable or appropriate.

(e) Removal of Restrictions. Except as otherwise provided in this Section 6 of the Equity Component, Shares of Restricted Stock covered by each Restricted Stock grant made under the Equity Component will be released from escrow as soon as practicable after the last day of the Period of Restriction or at such other time as the Administrator may determine. The Administrator, in its discretion, may accelerate the time at which any restrictions will lapse or be removed.

(f) Voting Rights. During the Period of Restriction, Service Providers holding Shares of Restricted Stock granted hereunder may exercise full voting rights with respect to those Shares, unless the Administrator determines otherwise.

(g) Dividends and Other Distributions. During the Period of Restriction, Service Providers holding Shares of Restricted Stock will be entitled to receive all dividends and other distributions paid with respect to such Shares, unless the Administrator provides otherwise. If any such dividends or distributions are paid in Shares, the Shares will be subject to the same restrictions on transferability and forfeitability as the Shares of Restricted Stock with respect to which they were paid.

(h) Return of Restricted Stock to Company. On the date set forth in the Equity Award Agreement, the Restricted Stock for which restrictions have not lapsed will revert to the Company and again will become available for grant under the Equity Component.

7. Restricted Stock Units.

(a) Grant. Restricted Stock Units may be granted at any time and from time to time as determined by the Administrator. After the Administrator determines that it will grant Restricted Stock Units under the Equity Component, it will advise the Equity Component Participant in an Equity Award Agreement of the terms, conditions, and restrictions related to the grant, including the number of Restricted Stock Units.

(b) Vesting Criteria and Other Terms. The Administrator will set vesting criteria in its discretion, which, depending on the extent to which the criteria are met, will determine the number of Restricted Stock Units that will be paid out to the Equity Component Participant. The Administrator may set vesting criteria based upon the achievement of Company-wide, divisional, business unit, or individual goals (including, but not limited to, continued employment or service), applicable federal or state securities laws or any other basis determined by the Administrator in its discretion.

(c) Earning Restricted Stock Units. Upon meeting the applicable vesting criteria, the Equity Component Participant will be entitled to receive a payout as determined by the Administrator. Notwithstanding the foregoing, at any time after the grant of Restricted Stock Units, the Administrator, in its sole discretion, may reduce or waive any vesting criteria that must be met to receive a payout.

(d) Form and Timing of Payment. Payment of earned Restricted Stock Units will be made as soon as practicable after the date(s) determined by the Administrator and set forth in the Equity Award Agreement. The Administrator, in its sole discretion, may only settle earned Restricted Stock Units in cash, Shares, or a combination of both.

(e) Cancellation. On the date set forth in the Equity Award Agreement, all unearned Restricted Stock Units will be forfeited to the Company.

#### 8. Stock Appreciation Rights.

(a) Grant of Stock Appreciation Rights. Subject to the terms and conditions of the Equity Component, a Stock Appreciation Right may be granted to Service Providers at any time and from time to time as will be determined by the Administrator, in its sole discretion.

(b) Number of Shares. The Administrator will have complete discretion to determine the number of Stock Appreciation Rights granted to any Service Provider.

(c) Exercise Price and Other Terms. The per share exercise price for the Shares to be issued pursuant to exercise of a Stock Appreciation Right will be determined by the Administrator and will be no less than 100% of the Fair Market Value per Share on the date of grant. Otherwise, the Administrator, subject to the provisions of the Equity Component, will have complete discretion to determine the terms and conditions of Stock Appreciation Rights granted under the Equity Component.

(d) Stock Appreciation Right Agreement. Each Stock Appreciation Right grant will be evidenced by an Equity Award Agreement that will specify the exercise price, the term of the Stock Appreciation Right, the conditions of exercise, and such other terms and conditions as the Administrator, in its sole discretion, will determine.

(e) Expiration of Stock Appreciation Rights. A Stock Appreciation Right granted under the Equity Component will expire upon the date determined by the Administrator, in its sole discretion, and set forth in the Equity Award Agreement. Notwithstanding the foregoing, the rules of Section 5(b) of the Equity Component relating to the maximum term and Section 5(d) of the Equity Component relating to exercise also will apply to Stock Appreciation Rights.

(f) Payment of Stock Appreciation Right Amount. Upon exercise of a Stock Appreciation Right, an Equity Component Participant will be entitled to receive payment from the Company in an amount determined by multiplying:

(i) The difference between the Fair Market Value of a Share on the date of exercise over the exercise price; times

(ii) The number of Shares with respect to which the Stock Appreciation Right is exercised.

At the discretion of the Administrator, the payment upon Stock Appreciation Right exercise may be in cash, in Shares of equivalent value, or in some combination thereof.

9. Performance Units and Performance Shares.

(a) Grant of Performance Units/Shares. Performance Units and Performance Shares may be granted to Service Providers at any time and from time to time, as will be determined by the Administrator, in its sole discretion. The Administrator will have complete discretion in determining the number of Performance Units and Performance Shares granted to each Equity Component Participant.

(b) Value of Performance Units/Shares. Each Performance Unit will have an initial value that is established by the Administrator on or before the date of grant. Each Performance Share will have an initial value equal to the Fair Market Value of a Share on the date of grant.

(c) Performance Objectives and Other Terms. The Administrator will set Performance Goals, performance objectives or other vesting provisions (including, without limitation, continued status as a Service Provider) in its discretion which, depending on the extent to which they are met, will determine the number or value of Performance Units/Shares that will be paid out to the Equity Component Participants. The time period during which the Performance Goals, performance objectives or other vesting provisions must be met will be called the "Performance Period." Each Equity Award of Performance Units/Shares will be evidenced by an Equity Award Agreement that will specify the Performance Period, and such other terms and conditions as the Administrator, in its sole discretion, will determine. The Administrator may set performance objectives based upon the achievement of Company-wide, divisional, business unit, or individual goals (including, but not limited to, continued employment or service), applicable federal or state securities laws, or any other basis determined by the Administrator in its discretion.

(d) Earning of Performance Units/Shares. After the applicable Performance Period has ended, the holder of Performance Units/Shares will be entitled to receive a payout of the number of Performance Units/Shares earned by the Equity Component Participant over the Performance Period, to be determined as a function of the extent to which the corresponding Performance Goals, performance objectives or other vesting provisions have been achieved. After the grant of a Performance Unit/Share, the Administrator, in its sole discretion, may reduce or waive any performance objectives or other vesting provisions for such Performance Unit/Share.

(e) Form and Timing of Payment of Performance Units/Shares. Payment of earned Performance Units/Shares will be made as soon as practicable after the expiration of the applicable Performance Period. The Administrator, in its sole discretion, may pay earned Performance Units/Shares in the form of cash, in Shares (which have an aggregate Fair Market Value equal to the value of the earned Performance Units/Shares at the close of the applicable Performance Period) or in a combination thereof.

(f) Cancellation of Performance Units/Shares. On the date set forth in the Equity Award Agreement, all unearned or unvested Performance Units/Shares will be forfeited to the Company, and again will be available for grant under the Equity Component.

10. Performance-Based Compensation Under Section 162(m).

(a) General. The provisions of this Section 10 of the Equity Component will control over any contrary provision in the Equity Component.

(b) Performance Goals. The granting and/or vesting of Equity Awards of Restricted Stock, Restricted Stock Units, Performance Shares and Performance Units under the Equity Component shall be made subject to the attainment of one or more Performance Goals. The Administrator will adjust any performance criteria, Performance Goal, or other feature of an Equity Award that relates to or is wholly or partially based on the number of, or the value of, any stock of the Company, to reflect any stock dividend or split, repurchase, recapitalization, combination, or exchange of shares or other similar changes in such stock. The Performance Goals may differ from Equity Component Participant to Equity Component Participant and from Equity Award to Equity Award. Prior to the Determination Date, the Administrator will determine whether any significant

element(s) will be included in or excluded from the calculation of any Performance Goal with respect to any Equity Component Participant.

(c) Procedures. To the extent necessary to comply with the performance-based compensation provisions of Section 162(m), no later than the Determination Date for each Performance Period, the Administrator will, in writing, (i) designate one or more Equity Component Participants to whom an Equity Award will be made, (ii) select the Performance Goals applicable to the Performance Period, (iii) establish the Performance Goals, and amounts of such Equity Awards, as applicable, which may be earned for such Performance Period, and (iv) specify the relationship between Performance Goals and the amounts of such Equity Awards, as applicable, to be earned by each Equity Component Participant for such Performance Period. Following the completion of each Performance Period, the Administrator will certify in writing whether the applicable Performance Goals have been achieved for such Performance Period. In determining the amounts earned by an Equity Component Participant, the Administrator will have the right to reduce or eliminate (but not to increase) the amount payable at a given level of performance to take into account additional factors that the Administrator may deem relevant to the assessment of individual or corporate performance for the Performance Period. An Equity Component Participant will be eligible to receive payment pursuant to an Equity Award for a Performance Period only if the Performance Goals for such period are achieved.

(d) Additional Limitations. Notwithstanding any other provision of the Equity Component, any Equity Award will be subject to any additional limitations set forth in the Code (including any amendment to Section 162(m)) or any regulations and ruling issued thereunder that are requirements for qualification as qualified performance-based compensation as described in Section 162(m), and the Equity Component will be deemed amended to the extent necessary to conform to such requirements.

11. Leaves of Absence/Transfer Between Locations. Unless the Administrator provides otherwise, vesting of Equity Awards granted hereunder will be suspended during any unpaid leave of absence. An Equity Component Participant will not cease to be an Employee in the case of (i) any leave of absence approved by the Company or (ii) transfers between locations of the Company or between the Company, its Parent, or any Subsidiary. For purposes of Incentive Stock Options, no such leave may exceed 3 months, unless reemployment upon expiration of such leave is guaranteed by statute or contract. If reemployment upon expiration of a leave of absence approved by the Company is not so guaranteed, then 6 months following the first day of such leave any Incentive Stock Option held by the Equity Component Participant will cease to be treated as an Incentive Stock Option and will be treated for tax purposes as a Nonstatutory Stock Option.

12. Transferability of Equity Awards. Unless determined otherwise by the Administrator, an Equity Award may not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner other than by will or by the laws of descent or distribution and may be exercised, during the lifetime of the Equity Component Participant, only by the Equity Component Participant. If the Administrator makes an Equity Award transferable, such Equity Award will contain such additional terms and conditions as the Administrator deems appropriate.

13. Adjustments; Dissolution or Liquidation; Merger or Change in Control.

(a) Adjustments. In the event that any dividend or other distribution (whether in the form of cash, Shares, other securities, or other property), recapitalization, stock split, reverse stock split, reorganization, merger, consolidation, split-up, spin-off, combination, repurchase, or exchange of Shares or other securities of the Company, or other change in the corporate structure of the Company affecting the Shares occurs, the Administrator, in order to prevent diminution or enlargement of the benefits or potential benefits intended to be made available under the Equity Component, will adjust the number, class, and price of Shares covered by each outstanding Equity Award and the numerical Share limits in Sections 1 and 4 of the Equity Component.

(b) Dissolution or Liquidation. In the event of the proposed dissolution or liquidation of the Company, the Administrator will notify each Equity Component Participant as soon as practicable prior to the effective date of such proposed transaction. To the extent it has not been previously exercised, an Equity Award will terminate immediately prior to the consummation of such proposed action.



(c) Change in Control. In the event of a merger of the Company with or into another corporation or other entity or a Change in Control, each outstanding Equity Award will be treated as the Administrator determines, including, without limitation, that each Equity Award be assumed or an equivalent option or right substituted by the successor corporation or a Parent or Subsidiary of the successor corporation. The Administrator will not be required to treat all Equity Awards similarly in the transaction.

In the event that the successor corporation does not assume or substitute for the Equity Award, the Equity Component Participant will fully vest in and have the right to exercise all of his or her outstanding Options and Stock Appreciation Rights, including Shares as to which such Equity Awards would not otherwise be vested or exercisable, and, with respect to Equity Awards with performance-based vesting, all performance goals or other vesting criteria will be deemed achieved at 100% of target levels and all other terms and conditions met. In addition, if an Option or Stock Appreciation Right is not assumed or substituted in the event of a Change in Control, the Administrator will notify the Equity Component Participant in writing or electronically that the Option or Stock Appreciation Right will be exercisable for a period of time determined by the Administrator in its sole discretion, and the Option or Stock Appreciation Right will terminate upon the expiration of such period.

For the purposes of this subsection (c), an Equity Award will be considered assumed if, following the Change in Control, the Equity Award confers the right to purchase or receive, for each Share subject to the Equity Award immediately prior to the Change in Control, the consideration (whether stock, cash, or other securities or property) received in the Change in Control by holders of Common Stock for each Share held on the effective date of the transaction (and if holders were offered a choice of consideration, the type of consideration chosen by the holders of a majority of the outstanding Shares); provided, however, that if such consideration received in the Change in Control is not solely common stock of the successor corporation or its Parent, the Administrator may, with the consent of the successor corporation, provide for the consideration to be received upon the exercise of an Option or Stock Appreciation Right or upon the payout of a Restricted Stock Unit, Performance Unit or Performance Share, for each Share subject to such Equity Award, to be solely common stock of the successor corporation or its Parent equal in fair market value to the per share consideration received by holders of Common Stock in the Change in Control.

Notwithstanding anything in this Section 13(c) of the Equity Component to the contrary, an Equity Award that vests, is earned or paid-out upon the satisfaction of one or more performance goals will not be considered assumed if the Company or its successor modifies any of such performance goals without the Equity Component Participant's consent; provided, however, a modification to such performance goals only to reflect the successor corporation's post-Change in Control corporate structure will not be deemed to invalidate an otherwise valid Equity Award assumption.

(d) Outside Director Equity Awards. With respect to Equity Awards granted to an Outside Director that are assumed or substituted for, if on the date of or following such assumption or substitution the Equity Component Participant's status as a Director or a director of the successor corporation, as applicable, is terminated other than upon a voluntary resignation by the Equity Component Participant (unless such resignation is at the request of the acquirer), then the Equity Component Participant will fully vest in and have the right to exercise Options and/or Stock Appreciation Rights as to all of the Shares underlying such Equity Award, including those Shares which would not otherwise be vested or exercisable, all restrictions on Restricted Stock and Restricted Stock Units will lapse, and, with respect to Performance Units and Performance Shares, all performance goals or other vesting criteria will be deemed achieved at one hundred percent (100%) of target levels and all other terms and conditions met.

#### 14. Tax.

(a) Withholding Requirements. Prior to the delivery of any Shares or cash pursuant to an Equity Award (or exercise thereof), or such earlier time as any tax withholding obligations are due, the Company will have the power and the right to deduct or withhold, or require an Equity Component Participant to remit to the Company, an amount sufficient to satisfy federal, state, local, foreign or other taxes (including the Equity

Component Participant's FICA obligation) required to be withheld with respect to such Equity Award (or exercise thereof).

(b) Withholding Arrangements. The Administrator, in its sole discretion and pursuant to such procedures as it may specify from time to time, may permit an Equity Component Participant to satisfy such tax withholding obligation, in whole or in part by (without limitation) (i) paying cash, (ii) electing to have the Company withhold otherwise deliverable cash or Shares having a Fair Market Value equal to the minimum statutory amount required to be withheld, or (iii) delivering to the Company already-owned Shares having a Fair Market Value equal to the minimum statutory amount required to be withheld. The Fair Market Value of the Shares to be withheld or delivered will be determined as of the date that the taxes are required to be withheld.

(c) Compliance With Section 409A. Equity Awards will be designed and operated in such a manner that they are either exempt from the application of, or comply with, the requirements of Section 409A such that the grant, payment, settlement or deferral will not be subject to the additional tax or interest applicable under Section 409A, except as otherwise determined in the sole discretion of the Administrator. The Equity Component and each Equity Award Agreement under the Equity Component is intended to meet the requirements of Section 409A and will be construed and interpreted in accordance with such intent, except as otherwise determined in the sole discretion of the Administrator. To the extent that an Equity Award or payment, or the settlement or deferral thereof, is subject to Section 409A the Equity Award will be granted, paid, settled or deferred in a manner that will meet the requirements of Section 409A, such that the grant, payment, settlement or deferral will not be subject to the additional tax or interest applicable under Section 409A.

15. No Effect on Employment or Service. Neither the Equity Component nor any Equity Award will confer upon an Equity Component Participant any right with respect to continuing the Equity Component Participant's relationship as a Service Provider with the Company or any Parent or Subsidiary of the Company, nor will they interfere in any way with the Equity Component Participant's right or the Company's right, or any Parent's or Subsidiary's right, to terminate such relationship at any time, with or without cause, to the extent permitted by Applicable Laws.

16. Date of Grant. The date of grant of an Equity Award will be, for all purposes, the date on which the Administrator makes the determination granting such Equity Award, or such other later date as is determined by the Administrator. Notice of the determination will be provided to each Equity Component Participant within a reasonable time after the date of such grant.

17. Conditions Upon Issuance of Shares.

(a) Legal Compliance. Shares will not be issued pursuant to the exercise of an Equity Award unless the exercise of such Equity Award and the issuance and delivery of such Shares will comply with Applicable Laws and will be further subject to the approval of counsel for the Company with respect to such compliance.

(b) Investment Representations. As a condition to the exercise of an Equity Award, the Company may require the person exercising such Equity Award to represent and warrant at the time of any such exercise that the Shares are being purchased only for investment and without any present intention to sell or distribute such Shares if, in the opinion of counsel for the Company, such a representation is required.

18. Inability to Obtain Authority. The inability of the Company to obtain authority from any regulatory body having jurisdiction or to complete or comply with the requirements of any registration or other qualification of the Shares under any state, federal or foreign law or under the rules and regulations of the Securities and Exchange Commission, the stock exchange on which Shares of the same class are then listed, or any other governmental or regulatory body, which authority, registration, qualification or rule compliance is deemed by the Company's counsel to be necessary or advisable for the issuance and sale of any Shares hereunder, will relieve the Company of any liability in respect of the failure to issue or sell such Shares as to which such requisite authority, registration, qualification, or rule compliance will not have been obtained.

**ARTICLE III**  
**OTHER TERMS**

1. Forfeiture Events.

(a) All Awards will be subject to recoupment under any clawback policy that the Company is required to adopt pursuant to the listing standards of any national securities exchange or association on which the Company's securities are listed or as is otherwise required by the Dodd-Frank Wall Street Reform and Consumer Protection Act or other applicable laws. In addition, the Administrator may impose such other clawback, recovery, or recoupment provisions in a Cash Award Agreement or Equity Award Agreement as the Administrator determines necessary or appropriate, including but not limited to a reacquisition right regarding previously acquired Shares or other cash or property. Unless this Section 1 of Article III is specifically mentioned and waived in a Cash Award Agreement, Equity Award Agreement, or other document, no recovery of compensation under a clawback policy or otherwise will be an event that triggers or contributes to any right of a Participant to resign for "good reason" or "constructive termination" (or similar term) under any agreement with the Company, any Parent or Subsidiary of the Company, or any Affiliate.

(b) The Administrator may specify in a Cash Award Agreement or Equity Award Agreement that the applicable Participant's rights, payments, and benefits with respect to such Participant's Actual Cash Award or Equity Award will be subject to reduction, cancellation, forfeiture, or recoupment upon the occurrence of specified events, in addition to any otherwise applicable vesting or performance conditions of an Actual Cash Award or Equity Award. Such events may include, but will not be limited to, a Cash Component Participant's Termination of Employment for cause, termination of an Equity Component Participant's status as a Service Provider for cause, or any specified action or inaction by the Participant, whether before or after the date of such Termination of Employment or termination of Service Provider status, that would constitute cause for such individual's Termination of Employment or termination of Service Provider status.

(c) If the Company is required to prepare an accounting restatement due to the material noncompliance of the Company, as a result of misconduct, with any financial reporting requirement under securities laws, any Participant who (i) knowingly or through gross negligence engaged in the misconduct or who knowingly or through gross negligence failed to prevent the misconduct or (ii) is one of the individuals subject to automatic forfeiture under Section 304 of the Sarbanes-Oxley Act of 2002, must reimburse the Company the amount of any payment in settlement of any Award earned or accrued during the 12-month period following the first public issuance or filing with the Securities and Exchange Commission (whichever first occurred) of the financial document embodying such financial reporting requirement.

2. Term of Plan. The Plan will become effective upon the Effective Date. It will continue in effect for a term of 5 years from the Effective Date, unless terminated earlier under Section 3 of this Article III.

3. Amendment and Termination.

(a) Amendment and Termination. The Board or Administrator may at any time amend, alter, suspend or terminate the Plan.

(b) Stockholder Approval. The Company will obtain stockholder approval of any Plan amendment to the extent necessary or desirable to comply with applicable laws.

(c) Consent of Participants Generally Required. Subject to Section 1(d)3(d) of this Article III, no amendment, alteration, suspension or termination of the Plan or an Award under it will impair the rights of any Participant, unless mutually agreed otherwise between such Participant and the Administrator, which agreement must be in writing and signed by the Participant and the Company (any such agreement with respect to an award

under the Cash Component, a “Cash Award Agreement”). Termination of the Plan will not affect the Administrator’s ability to exercise the powers granted to it regarding Awards established under the Plan prior to such termination.

(d) Exceptions to Consent Requirement.

(i) A Participant’s rights will not be deemed to have been impaired by any amendment, alteration, suspension or termination if the Administrator, in its sole discretion, determines that the amendment, alteration, suspension or termination does not materially impair the Participant’s rights, and

(ii) subject to any limitations of applicable laws, the Administrator may amend the terms of any Awards under the Plan without the affected Participant’s consent even if it does materially impair the Participant’s right if such amendment is done:

(1) in a manner permitted under the Plan;

(2) to avoid imposition of any additional tax or income recognition under Section 409A prior to actual payment to the Participant;

(3) to comply with other applicable laws; or

(4) as necessary based on rulings or guidance issued to ensure compliance with the requirements of Section 162(m).

4. Stockholder Approval. The Plan will be subject to approval by the stockholders of the Company within 12 months after the date the Plan is adopted. Such stockholder approval will be obtained in the manner and to the degree required under applicable laws.

5. Law Governing. The validity and construction of the Plan shall be governed by the laws of the State of California but without regard to the choice of law principles thereof.

6. Definitions. As used herein, the following definitions will apply to the Plan, and any term not specifically defined herein shall have the meaning ascribed to it in the Equity Plan:

(a) “Actual Cash Award” means as to any Performance Period, the actual award (if any) payable to a Cash Component Participant for the Performance Period. Each Actual Cash Award is determined by the Payout Calculation Methodology for the Performance Period, subject to the Administrator’s authority under Section 3(d)(ii) of the Cash Component to eliminate or reduce the award otherwise determined by the Payout Calculation Methodology. To apply the Maximum Cash Award limitation, the Actual Cash Award will be deemed to have been determined on the last day of the applicable Performance Period, so that if there are multiple Performance Periods ending in a particular fiscal year of the Company, the Actual Cash Awards, in the aggregate, may not exceed the Maximum Cash Award regarding all such Performance Periods ending in that fiscal year of the Company.

(b) “Administrator” means the Compensation Committee of the Board or any other Committee.

(c) “Affiliate” means any corporation or other entity (including, but not limited to, partnerships and joint ventures) controlled by the Company.

(d) “Applicable Laws” means the requirements relating to the administration of equity-based awards under U.S. state corporate laws, U.S. federal and state securities laws, the Code, any stock exchange or quotation system on which the Common Stock is listed or quoted and the applicable laws of any foreign country or jurisdiction where Equity Awards are, or will be, granted under the Equity Component.

(e) “Award” means an award under the Cash Component or an Equity Award.

(f) “Board” means the Board of Directors of the Company.

(g) “Cash Component Participant” means as to any Performance Period, an employee of the Company or an Affiliate selected by the Administrator for participation in the Cash Component for that Performance Period.

(h) “Change in Control” means the occurrence of any of the following events:

(i) A change in the ownership of the Company which occurs on the date that any one person, or more than one person acting as a group (“Person”), acquires ownership of the stock of the Company that, together with the stock held by such Person, constitutes more than 50% of the total voting power of the stock of the Company; provided, however, that for purposes of this subsection (i), the acquisition of additional stock by any one Person, who is considered to own more than 50% of the total voting power of the stock of the Company will not be considered a Change in Control; or

(ii) A change in the effective control of the Company which occurs on the date that a majority of members of the Board is replaced during any 12 month period by Directors whose appointment or election is not endorsed by a majority of the members of the Board prior to the date of the appointment or election. For purposes of this clause (ii), if any Person is considered to be in effective control of the Company, the acquisition of additional control of the Company by the same Person will not be considered a Change in Control; or

(iii) A change in the ownership of a substantial portion of the Company’s assets which occurs on the date that any Person acquires (or has acquired during the 12 month period ending on the date of the most recent acquisition by such person or persons) assets from the Company that have a total gross fair market value equal to or more than 50% of the total gross fair market value of all of the assets of the Company immediately prior to such acquisition or acquisitions; provided, however, that for purposes of this subsection (iii), the following will not constitute a change in the ownership of a substantial portion of the Company’s assets: (A) a transfer to an entity that is controlled by the Company’s stockholders immediately after the transfer, or (B) a transfer of assets by the Company to: (1) a stockholder of the Company (immediately before the asset transfer) in exchange for or with respect to the Company’s stock, (2) an entity, 50% or more of the total value or voting power of which is owned, directly or indirectly, by the Company, (3) a Person, that owns, directly or indirectly, 50% or more of the total value or voting power of all the outstanding stock of the Company, or (4) an entity, at least 50% of the total value or voting power of which is owned, directly or indirectly, by a Person described in this subsection (iii)(B)(3). For purposes of this subsection (iii), gross fair market value means the value of the assets of the Company, or the value of the assets being disposed of, determined without regard to any liabilities associated with such assets.

For purposes of this definition, persons will be considered to be acting as a group if they are owners of a corporation that enters into a merger, consolidation, purchase or acquisition of stock, or similar business transaction with the Company.

Notwithstanding the foregoing, a transaction will not be deemed a Change in Control unless the transaction qualifies as a change in control event within the meaning of Section 409A, as it has been and may be amended from time to time, and any proposed or final Treasury Regulations and Internal Revenue Service guidance that has been promulgated or may be promulgated thereunder from time to time.

Further and for the avoidance of doubt, a transaction will not constitute a Change in Control if: (i) its sole purpose is to change the state of the Company’s incorporation, or (ii) its sole purpose is to create a holding company that will be owned in substantially the same proportions by the persons who held the Company’s securities immediately before such transaction.

(i) “Code” means the U.S. Internal Revenue Code of 1986, as amended. Reference to a specific section of the Code or regulation thereunder shall include such section or regulation, any valid regulation promulgated under such section, and any comparable provision of any future legislation or regulation amending, supplementing, or superseding such section or regulation.

(j) “Committee” means a duly authorized committee of the Board consisting of 2 or more “outside directors” within the meaning of Section 162(m).

(k) “Common Stock” means the common stock of the Company.

(l) “Consultant” means any person, including an advisor, engaged by the Company or a Parent or Subsidiary to render services to such entity.

(m) “Covered Employee” means any Service Provider who would be considered a “covered employee” within the meaning of Section 162(m).

(n) “Determination Date” means the latest possible date that will not jeopardize the qualification of an Actual Cash Award or Equity Award as “performance-based compensation” under Section 162(m).

(o) “Director” means a member of the Board.

(p) “Disability” means a permanent and total disability determined under uniform and nondiscriminatory standards adopted by the Administrator from time to time; provided, however, that in the case of Incentive Stock Options, “Disability” means total and permanent disability as defined in Section 22(e)(3) of the Code.

(q) “Employee” means any person, including Directors, employed by the Company or any Parent or Subsidiary of the Company. Neither service as a Director nor payment of a director’s fee by the Company will be sufficient to constitute “employment” by the Company.

(r) “Equity Award” means, individually or collectively, a grant under the Equity Component of Options, Restricted Stock, Restricted Stock Units, Stock Appreciation Rights, Performance Units, or Performance Shares.

(s) “Equity Award Agreement” means the written or electronic agreement setting forth the terms and provisions applicable to each Equity Award granted under the Equity Component. The Equity Award Agreement is subject to the terms and conditions of the Equity Component.

(t) “Equity Component Participant” means the holder of an outstanding Equity Award.

(u) “Equity Plan” means the Company’s 2012 Equity Incentive Plan as hereinafter may be amended.

(v) “Exchange Act” means the U.S. Securities Exchange Act of 1934, as amended.

(w) “Exchange Program” means a program under which (i) outstanding Equity Awards are surrendered or cancelled in exchange for awards of the same type (which may have higher or lower exercise prices and different terms), awards of a different type, and/or cash, (ii) Equity Component Participants would have the opportunity to transfer any outstanding Equity Awards to a financial institution or other person or entity selected by the Administrator, and/or (iii) the exercise price of an outstanding Equity Award is increased or reduced.

(x) “Fair Market Value” means, as of any date, the value of Common Stock determined as follows:

(i) If the Common Stock is listed on any established stock exchange or a national market system, including without limitation the New York Stock Exchange, the NASDAQ Global Select Market, the NASDAQ Global Market or the NASDAQ Capital Market of The NASDAQ Stock Market, its Fair Market Value will be the closing sales price for such stock (or the closing bid, if no sales were reported) as quoted on such exchange or system on the day of determination, as reported in *The Wall Street Journal* or such other source as the Administrator deems reliable;

(ii) If the Common Stock is regularly quoted by a recognized securities dealer but selling prices are not reported, the Fair Market Value of a Share will be the mean between the high bid and low asked prices for the Common Stock on the day of determination (or, if no bids and asks were reported on that date, as applicable, on the last trading date such bids and asks were reported), as reported in *The Wall Street Journal* or such other source as the Administrator deems reliable; or

(iii) In the absence of an established market for the Common Stock, the Fair Market Value will be determined in good faith by the Administrator.

(y) “Fiscal Year” means the fiscal year of the Company.

(z) “Incentive Stock Option” means an Option intended to qualify as an incentive stock option within the meaning of Section 422 of the Code and the regulations promulgated thereunder.

(aa) “Maximum Cash Award” means as to any Cash Component Participant for any fiscal year of the Company, \$5,000,000.

(bb) “Nonstatutory Stock Option” means an Option that by its terms does not qualify or is not intended to qualify as an Incentive Stock Option.

(cc) “Option” means a stock option granted pursuant to the Equity Component.

(dd) “Outside Director” means a Director who is not an Employee.

(ee) “Parent” means a “parent corporation,” whether now or hereafter existing, as defined in Section 424(e) of the Code.

(ff) “Participant” means a Cash Component Participant or an Equity Component Participant.

(gg) “Payout Calculation Methodology” means as to any Performance Goal, the methodology for calculating the maximum amount earned by performance against the Performance Goal.

(hh) “Performance Goals” mean any one or more of the following objective performance criteria, applied to either the Company or, except regarding stockholder return metrics, to a region, business unit, affiliate or business segment, and measured either on an absolute basis, a per share basis or relative to a pre-established target, to a previous period’s results or to a designated comparison group, and, with respect to financial metrics, which may be determined under United States Generally Accepted Accounting Principles (“GAAP”), under accounting principles established by the International Accounting Standards Board (“IASB Principles”) or which may be adjusted when established to exclude any items otherwise includable under GAAP or under IASB Principles: (i) cash flow (including operating cash flow or free cash flow), (ii) revenue (on an absolute basis or adjusted for currency effects), (iii) gross margin, (iv) operating expenses or operating expenses as a percentage of revenue, (v) earnings (which may include earnings before interest and taxes, earnings before taxes, net earnings or EBITDA), (vi) earnings per share, (vii) stock price, (viii) return on equity, (ix) total stockholder return,

(x) growth in stockholder value relative to the moving average of the S&P 500 Index, or another index, (xi) return on capital, (xii) return on assets or net assets, (xiii) return on investment, (xiv) operating income or net operating income, (xv) operating margin, (xvi) market share, (xvii) overhead or other expense reduction, (xviii) objective customer indicators, (xix) improvements in productivity, (xx) attainment of objective operating goals, (xxi) objective employee metrics, (xxii) return ratios, (xxiii) objective qualitative milestones, or (xxiv) other objective financial or other metrics relating to the progress of the Company, any Parent or Subsidiary of the Company, any Affiliate (with respect to Actual Cash Awards only), or any division or department thereof. Each Performance Goal may be expressed on an absolute and/or relative basis, may be based on, or otherwise employ, comparisons based on internal targets, the past performance of the Company and/or the past or current performance of other companies. Unless the Administrator provides otherwise in accordance with the preceding sentence, Performance Goals will be calculated in accordance with the Company's financial statements, generally accepted accounting principles, or under a methodology established by the Administrator prior to or at the time of the issuance of an Equity Award and which is consistently applied with respect to a Performance Goal in the relevant Performance Period.

(ii) "Performance Period" means any Fiscal Year of the Company or such other period as determined by the Administrator, in its sole discretion.

(jj) "Performance Share" means an Equity Award denominated in Shares which may be earned in whole or in part upon attainment of Performance Goals, performance objectives, or other vesting criteria as the Administrator may determine pursuant to Section 9 of the Equity Component.

(kk) "Performance Unit" means an Equity Award which may be earned in whole or in part upon attainment of Performance Goals, performance objectives, or other vesting criteria as the Administrator may determine and which may be settled for cash, Shares or other securities or a combination of the foregoing pursuant to Section 9 of the Equity Component, and which, for the avoidance, will include any Restricted Stock Units (as defined in Equity Plan) which may be earned in whole or in part upon attainment of Performance Goals or performance objectives in accordance with the same terms as applicable to Performance Units described herein.

(ll) "Restricted Stock" means Shares issued pursuant to a Restricted Stock award under Section 6 of the Equity Component, or issued pursuant to the early exercise of an Option.

(mm) "Restricted Stock Unit" means a bookkeeping entry representing an amount equal to the Fair Market Value of one Share, granted pursuant to Section 7 of the Equity Component. Each Restricted Stock Unit represents an unfunded and unsecured obligation of the Company.

(nn) "Rule 16b-3" means Rule 16b-3 of the Exchange Act or any successor to Rule 16b-3, as in effect when discretion is being exercised with respect to the Equity Component.

(oo) "Section 16(b)" means Section 16(b) of the Exchange Act.

(pp) "Section 162(m)" means Section 162(m) of the Code and the regulations and interpretations promulgated thereunder.

(qq) "Section 409A" means Section 409A of the Code and any proposed, temporary, or final U.S. Treasury Regulations and U.S. Internal Revenue Service guidance, as each may be amended from time to time.

(rr) "Service Provider" means an Employee, Director, or Consultant.

(ss) "Share" means a share of the Common Stock, as adjusted in accordance with Section 13 of the Equity Plan and/or Section 13 of the Equity Component.



(tt) “Stock Appreciation Right” means an Equity Award, granted alone or in connection with an Option, that pursuant to Section 8 of the Equity Component is designated as a Stock Appreciation Right.

(uu) “Subsidiary” means a “subsidiary corporation”, whether now or hereafter existing, as defined in Section 424(f) of the Code.

(vv) “Termination of Employment” means a cessation of the employee-employer relationship between a Cash Component Participant and the Company or an Affiliate for any reason, including, but not by way of limitation, a termination by resignation, discharge, death, Disability, retirement, or the disaffiliation of an Affiliate, but excluding any such termination where there is a simultaneous reemployment by the Company or an Affiliate.

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**Palo Alto Networks, Inc.**  
**2017 Annual Report**

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

**FORM 10-K**

(Mark One)

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

For the fiscal year ended July 31, 2017

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 001-35594

**Palo Alto Networks, Inc.**

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

20-2530195  
(I.R.S. Employer  
Identification No.)

3000 Tannery Way  
Santa Clara, California 95054  
(Address of principal executive offices, including zip code)

(408) 753-4000  
(Registrant's telephone number, including area code)

**Securities registered pursuant to Section 12(b) of the Act:**

Title of each class	Name of each exchange on which registered
Common Stock, par value \$0.0001 per share	New York Stock Exchange LLC

**Securities registered pursuant to Section 12(g) of the Act:**

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer <input checked="" type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>
	Emerging growth company <input type="checkbox"/>

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The aggregate market value of voting stock held by non-affiliates of the registrant was \$13,100,300,364 as of January 31, 2017, the last business day of the registrant's most recently completed second fiscal quarter (based on the closing sales price for the common stock on the New York Stock Exchange on such date). Shares of common stock held by each executive officer, director, and holder of 5% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

On August 24, 2017, 91,842,364 shares of the registrant's common stock, \$0.0001 par value, were outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the information called for by Part III of this Annual Report on Form 10-K is hereby incorporated by reference from the definitive proxy statement for the registrant's annual meeting of stockholders, which will be filed with the Securities and Exchange Commission not later than 120 days after the registrant's fiscal year ended July 31, 2017.

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## PART I

### SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K, including the sections entitled “Business,” “Risk Factors,” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” 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. The words “believe,” “may,” “will,” “potentially,” “estimate,” “continue,” “anticipate,” “intend,” “could,” “would,” “project,” “plan,” “expect,” and similar expressions that convey uncertainty of future events or outcomes are intended to identify forward-looking statements.

These forward-looking statements include, but are not limited to, statements concerning the following:

- trends in and expectations regarding revenue (including our revenue mix), costs of revenue, gross margin, cash flows, interest expense, and operating expenses (including future share-based compensation expense);
- our ability to and expectation that we will continue to grow our installed end-customer base;
- our expectations regarding future investments in research and development, customer support, and in our sales force, including expectations regarding growth in our sales headcount;
- our ability to develop or acquire new product, subscription, and support offerings, improve our existing product, subscription, and support offerings, and increase the value of our product, subscription, and support offerings;
- our expectation that we will continue to expand internationally;
- our expectation that we will continue to renew existing contracts and increase sales to our existing customer base;
- seasonal trends in our results of operations;
- our expectation that we will expand our facilities or add new facilities as we add employees and enter new geographic markets and expectations related to charges incurred in connection with exiting our former headquarter facilities;
- the sufficiency of our cash flow from operations with existing cash and cash equivalents to meet our cash needs for the foreseeable future;
- future investments in product development, subscriptions, or technologies, and any related delays in the development or release of new product and subscription offerings;
- our ability to successfully acquire and integrate companies and assets; and
- the timing and amount of capital expenditures and share repurchases.

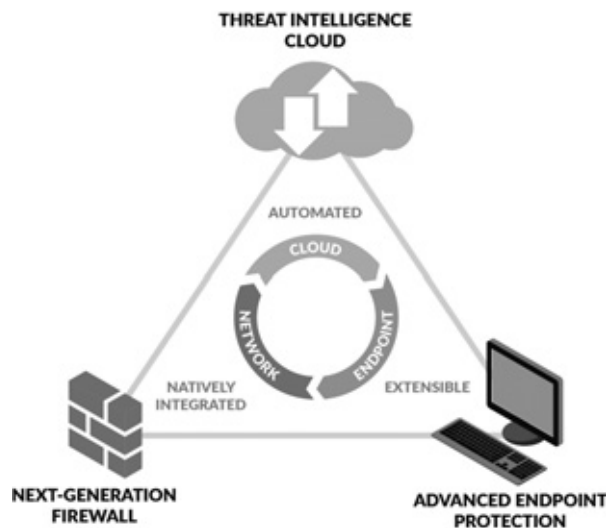
These forward-looking statements are subject to a number of risks, uncertainties, and assumptions, including those described in “Risk Factors” included in Part I, Item 1A and elsewhere in this Annual Report on Form 10-K. Moreover, we operate in a very competitive and rapidly changing environment, and new risks emerge from time to time. It is not possible for our management to predict all risks, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements we may make. In light of these risks, uncertainties, and assumptions, the forward-looking events and circumstances discussed in this Annual Report on Form 10-K may not occur, and actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements. We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements, except as required by law. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

## ITEM 1. BUSINESS

### General

We have pioneered the next generation of security through our innovative platform that allows enterprises, service providers, and government entities to secure their organizations by safely enabling applications running on their networks and by preventing successful breaches that stem from targeted cyberattacks. Our platform uses an innovative traffic classification engine that identifies network traffic by application, user, and content and provides consistent security across the network, endpoint, and cloud. Accordingly, our platform enables our end-customers to maintain the visibility and control needed to protect their valued data and critical control systems while pursuing technology initiatives, like cloud and mobility, that grow their business. We believe our platform offers superior performance compared to legacy approaches and reduces the total cost of ownership for organizations by simplifying their security operations and infrastructure and eliminating the need for multiple, stand-alone security appliances and software products.

Our Next-Generation Security Platform consists of three major elements: our Next-Generation Firewall, our Advanced Endpoint Protection, and our Threat Intelligence Cloud.



Our Next-Generation Firewall comes in several physical and cloud-based software form-factors and delivers application, user, and content visibility and control as well as protection against network-based cyberthreats integrated within the firewall through our proprietary hardware and software architecture. Our Advanced Endpoint Protection software prevents cyberattacks that aim to run malicious code or exploit software vulnerabilities on a broad variety of fixed, mobile, and virtual endpoints and servers. Our Threat Intelligence Cloud provides central intelligence capabilities, security for software as a service (“SaaS”) applications, and automated delivery of preventative measures against cyberattacks.

We were incorporated in 2005 as Palo Alto Networks, Inc., a Delaware corporation. Our corporate headquarters are located in Santa Clara, California.

### Product, Subscription, and Support Offerings

**Firewall Appliances and Software.** All of our firewall appliances and software incorporate our PAN-OS operating system and come with the same rich set of features ensuring consistent operation across our entire product line. These features include: App-ID, User-ID, site-to-site virtual private network (“VPN”), remote access Secure Sockets Layer (“SSL”) VPN, and Quality-of-Service (“QoS”). Our appliances and software are designed for different performance requirements throughout an organization and are classified based on throughput, ranging from our PA-200, which is designed for enterprise remote offices, to our top-of-the-line PA-7080, which is designed for large scale data centers and service provider use. Our firewall appliances come in a phys-



ical form factor as well as in a virtual form factor, called VM-Series, that is available for virtualization and cloud environments from companies such as VMware, Inc. (“VMware”), Microsoft Corporation (“Microsoft”), and Amazon.com, Inc. (“Amazon”), and in Kernel-based Virtual Machine (“KVM”)/OpenStack environments.

**Panorama.** Panorama is our centralized security management solution for global control of all of our firewall appliances and software deployed on an end-customer’s network as well as in their instances in public cloud environments as a virtual appliance or a physical appliance. Panorama is used for centralized policy management, device management, software licensing and updates, centralized logging and reporting, and log storage. Panorama controls the security, network address translation (“NAT”), QoS, policy based forwarding, decryption, application override, captive portal, and distributed denial of service/denial of service (“DDoS/DoS”) protection aspects of the appliances, software, and virtual systems under management. Panorama centrally manages device software and associated updates, including SSL-VPN clients, GlobalProtect clients, dynamic content updates, and software licenses. Panorama offers the ability to view logs and run reports from all managed appliances and software without the need to forward the logs and to report on aggregate user activity for all users, including mobile users. Panorama reliably expands the log storage for long-term event investigation and analysis through high-availability features for central management.

**Virtual System Upgrades.** Virtual System Upgrades are available as extensions to the Virtual System capacity that ships with our physical appliances. Virtual Systems provide a mechanism to support multiple distinct security policies and administrative access for tenants on the same hardware device, which is applicable to our large enterprise and service provider end-customers.

**Subscription Offerings.** We offer a number of subscriptions as part of our platform. Of these subscription offerings, Threat Prevention Subscription, URL Filtering Subscription, WildFire Subscription, and GlobalProtect Subscription are sold as options to our firewall appliances and software, whereas VM-Series, Traps, AutoFocus, Aperture, GlobalProtect cloud service, and Logging Service are sold on a per-user, per-endpoint, or capacity-based basis. Our subscription offerings include:

- **Threat Prevention Subscription.** This subscription provides the intrusion detection and prevention capabilities of our platform. Our threat prevention engine blocks vulnerability exploits, viruses, spyware, buffer overflows, denial-of-service attacks, and port scans from compromising and damaging enterprise information resources. It includes mechanisms such as protocol decoder-based analysis, protocol anomaly-based protection, stateful pattern matching, statistical anomaly detection, heuristic-based analysis, custom vulnerability, and spyware “phone home” signatures.
- **URL Filtering Subscription.** This subscription provides the uniform resource locator (“URL”) filtering capabilities of our platform. The URL filtering database consists of millions of URLs across many categories and is designed to monitor and control employee web surfing activities. The on-appliance URL database can be augmented to suit the traffic patterns of the local user community with a custom URL database. URLs that are not categorized by the local URL database can be pulled into a separate, cache-based URL database from a very extensive, cloud-based URL database.
- **WildFire Subscription.** This cloud-based or appliance-based subscription provides protection against targeted malware and advanced persistent threats, and provides a near real-time analysis engine for detecting previously unseen malware. The core component of this subscription is a sandbox environment that can operate on an end-customer’s private cloud or our public cloud where files can be run and monitored for more than 100 behavioral characteristics that identify the file as malware. Once identified, preventive measures are automatically generated and delivered to all subscribed devices. By providing this as a cloud-based subscription, all of our end-customers benefit from malware found on any network.
- **GlobalProtect Subscription.** This appliance-based subscription provides protection for mobile users of both traditional laptop devices and mobile devices. It expands the boundaries of the physical network, effectively establishing a logical perimeter that encompasses remote laptop and mobile device users irrespective of their location. When a remote user logs into the device, GlobalProtect automatically determines the closest gateway available to the roaming device and establishes a secure connection.

Windows and Apple laptops as well as mobile devices, such as Android phones and tablets and Apple iPhones and iPads, will stay connected to the corporate network whenever they are on a network of any kind. As a result, they are protected as if they never left the corporate campus. GlobalProtect ensures that the same secure application enablement policies that protect users at the corporate site are enforced for all users, independent of their location.

- ***VM-Series Subscription.*** VM-Series, the software form factor of our Next-Generation Firewall, is offered as both a perpetual license as well as a term-based subscription. The VM-Series provides all of the same security capabilities of our hardware appliances, but is delivered as a software package that can be deployed on VMware's NSX and ESXi, Microsoft's Hyper-V, and Red Hat KVM hypervisors, as well as natively in Amazon Web Services cloud and Microsoft Azure cloud.
- ***Traps Endpoint Protection Subscription.*** This subscription provides protection for endpoints against cyberattacks that aim to run malicious code or exploit software vulnerabilities. It prevents known and previously unknown attacks through its unique capability of stopping the underlying exploit techniques and can prevent cyberattacks without relying on prior knowledge of the attack. Through its integration with WildFire, it is also capable of preventing cyberattacks that rely on malware.
- ***AutoFocus Subscription.*** This cloud-based subscription provides threat intelligence capabilities to our end-customers' security operations teams. Indicators of compromise and anomalies that occur on an end-customer's network can be correlated with similar data that has been centrally collected by us in our Threat Intelligence Cloud from among all our participating end-customers. This offers our end-customers priority alerts, deep attack context, and high-fidelity threat intelligence across millions of malware samples and tens of billions of file artifacts.
- ***Aperture Subscription.*** This cloud-based subscription provides content control for IT-sanctioned SaaS applications that are used to store and share end-customer's data. It offers end-customers the capability to safely use these SaaS applications and avert risks associated with improper sharing of confidential data and risks associated with sharing of malicious content.
- ***GlobalProtect Cloud Service Subscription.*** This cloud-based subscription, expected to be released in September 2017, enables our end-customers to utilize the preventive capabilities of our Next-Generation Security Platform to secure remote offices and mobile users, providing consistent protection across globally distributed network and cloud environments without the need for firewall appliances or software in the remote locations. With this offering, our end-customers can quickly and easily add or remove remote locations and users, and establish and adjust security policies as needed, using a multi-tenant, cloud-based security infrastructure that we operate on their behalf.
- ***Logging Service Subscription.*** This cloud-based subscription, expected to be released in September 2017, allows our end-customers to collect large amounts of context-rich enhanced network logs generated by our security offerings, including those of our firewalls and GlobalProtect Cloud-Based Security subscription, without needing to plan for local compute and storage.

***Support.*** We offer Standard Support, Premium Support, and four-hour Premium Support to our end-customers and channel partners. Our channel partners that operate a Palo Alto Networks Authorized Support Center ("ASC") typically deliver level-one and level-two support. We provide level-three support 24 hours a day, seven days a week through regional support centers that are located worldwide. We also offer an annual subscription-based Technical Account Management ("TAM") service that provides dedicated support for end-customers with unique or complex support requirements. We offer our end-customers ongoing support for both hardware and software in order to receive ongoing security updates, PAN-OS upgrades, bug fixes, and repair. End-customers typically purchase these services for a one-year or longer term at the time of the initial product sale and typically renew for successive one-year or longer periods. Additionally, we provide expedited replacement for any defective hardware. We use a third-party logistics provider to manage our worldwide deployment of spare appliances and other accessories.

***Professional Services.*** Professional services are primarily delivered through our authorized channel partners and include on-location, hands-on experts who plan, design, and deploy effective security solutions tailored to

our end-customers' specific requirements. These services include application traffic management, solution design and planning, configuration, and firewall migration. Our education services provide online and classroom-style training and are also primarily delivered through our authorized partners.

## **Technology**

We combine our proprietary hardware and software architecture, PAN-OS operating system, Traps, and Threat Intelligence Cloud to provide a comprehensive security platform. Our Next-Generation Firewall integrates application visibility and control and is comprised of three identification technologies: App-ID, User-ID, and Content-ID. These technologies allow organizations to enable the secure use of applications while managing the inherent risks of doing so. These fine-grained policy management and enforcement capabilities are delivered at low latency, multi-gigabit performance through our innovative single-pass, parallel processing ("SP3") architecture.

**App-ID.** App-ID is our application classification engine that uses multiple identification techniques to determine the exact identity of applications traversing the network. App-ID is the foundational classification engine that provides the core traffic classification to all other functions in our platform. The App-ID classification is used to invoke other security functions.

App-ID uses a series of classification techniques to accurately identify an application. When traffic first enters the network, App-ID applies an initial policy check based on Internet Protocol ("IP") and port. Signatures are then applied to the traffic to identify the application based on application properties and related transaction characteristics. If the traffic is encrypted and a decryption policy is in place, the application is first decrypted, then application signatures are applied. Additional context-based signature analysis is then performed to identify known protocols that may be hiding other applications. Encrypted traffic that was decrypted is then re-encrypted before being sent back into the network. For evasive applications that cannot be identified through advanced signature and protocol analysis, heuristics or behavioral analysis are used to determine the identity of the application. When an application is accurately identified during this series of successive techniques, the policy check determines how to treat the application and associated functions. The policy check can block the application, allow it and scan for threats, inspect it for unauthorized file transfer and data patterns, or shape its use of network resources by applying a quality-of-service policy.

App-ID consistently classifies all network traffic, including business applications, consumer applications, and network protocols, across all ports. Consequently, there is no need to perform a series of signature checks to look for an application that is thought to be on the network. App-ID continually monitors the state of the application to determine if the application changes. Our platform allows only those applications within the policy to enter the network, while all other applications are blocked.

Internally developed or custom applications can be managed using either an application override or custom App-IDs. End-customers can use either of these mechanisms to apply the same level of control over their internal or custom applications that they apply to common applications. Because the application landscape is constantly changing, our research teams are constantly updating our App-ID classification engine. We deliver updated App-IDs automatically to our end-customers through our weekly update service.

**User-ID.** User-ID integrates our platform with a wide range of enterprise user directories and technologies, including Active Directory, eDirectory, Open LDAP, Citrix Terminal Server, Microsoft Exchange, Microsoft Terminal Server, and ZENworks. A network-based, User-ID agent communicates with the domain controllers, directories, or supported enterprise applications, mapping information such as user, role, and current IP address to the firewall, making the policy integration transparent. In cases where user repository information does not include the current IP address of the user, a transparent, captive portal authentication or challenge/response mechanism can be used to tie users into the security policy. In cases where a user repository or application is in place that already has knowledge of users and their current IP address, a standards-based application programming interface ("API") can be used to tie the repository to our platform.

**Content-ID.** Content-ID is a collection of technologies that enables many of our subscription services. Content-ID combines a real-time threat prevention engine, a cloud-based analysis service, and a comprehensive

URL categorization database to limit unauthorized data and file transfers, detect and block a wide range of threats, and control non-work related web surfing.

The threat prevention engine blocks several common types of attacks, including vulnerability exploits, buffer overflows, and port scans from compromising and damaging enterprise information resources. It includes mechanisms such as protocol decoder-based analysis, protocol anomaly-based protection, stateful pattern matching, statistical anomaly detection, heuristic-based analysis, custom vulnerability, and spyware “phone home” signatures.

Our cloud-based threat analysis service, WildFire, provides a near real-time analysis engine for detecting previously unseen targeted malware. The core component of WildFire is a sandbox environment that can be deployed in a customer’s private cloud or on our cloud where files can be run and monitored for more than 100 behavioral characteristics that identify the file as malware. Once identified, signatures are automatically generated and delivered to all end-customers that subscribe to the WildFire service. By providing WildFire as a cloud-based service, all of our end-customers benefit from malware found on any network or endpoint. Refer to the “WildFire” section below for a more detailed discussion of our WildFire technology.

Our URL filtering database consists of millions of URLs across many categories and is designed to monitor and control employee web surfing activities. The on-appliance URL database can be augmented to suit the traffic patterns of the local user community with a custom URL database. URLs that are not categorized by the local URL database can be pulled into an on-appliance data cache from a very extensive, cloud-based URL database. The data filtering features in our platform enable policies that reduce the risks associated with the transfer of unauthorized files and data. This can be achieved by blocking files by type, by controlling sensitive data, such as credit card and social security numbers in application content or attachments, and by controlling file transfers within applications.

**SP3.** SP3 is our proprietary software and hardware architecture that is comprised of two elements: single-pass software and parallel processing hardware.

Our single-pass software accomplishes two key functions in our platform. First, it performs operations once per packet. As a packet is processed, the networking functions, the policy lookup, the application identification and decoding, and the signature matching for any and all threats and content are all performed simultaneously. This significantly reduces the amount of processing required to perform multiple functions in one security device. Second, the content scanning step is stream-based and uses uniform signature matching to detect and block threats. Instead of using multiple scanning passes and file proxies, which require download prior to scanning, our single-pass software scans content once in a stream-based fashion to minimize latency. This results in very high throughput and low latency, even with all security functions active. It also offers a single, fully integrated policy, thus enabling easier management of security.

Our parallel processing hardware is designed to optimize single-pass software performance through the use of separate data and control planes, which means that heavy utilization of one does not negatively impact the performance of the other. Our hardware also uses discrete, specialized processing groups to perform critical functions. On the data plane, this includes functions such as networking, policy enforcement, encryption and decryption, decompression, and content scanning. On the control plane, this includes configuration management, logging, and reporting.

We believe that the combination of single-pass software and parallel processing hardware is unique in the enterprise security industry and allows our platform to safely enable applications and prevent cyberthreats at very high levels of performance and throughput.

**PAN-OS Operating System.** Our PAN-OS operating system provides the foundation for our security platform and contains App-ID, User-ID, and Content-ID. PAN-OS performs the core functions of our platform while also providing the networking, security, and management functions needed for implementation. The PAN-OS networking functions include dynamic routing, switching, high availability, and VPN support, which enables deployment into a broad range of networking environments.

We have the ability to enable a series of virtual firewall instances or virtual systems. Each virtual system is an independent (virtual) firewall within the device that is managed separately and cannot be accessed or viewed

by any other administrator of any other virtual system. This capability allows enterprises and service providers to separate firewall instances in departmental and multi-tenant managed services scenarios.

The security functions in PAN-OS are implemented in a single security policy and include application, application function, user, group, port, and service-based elements. Policy responses can range from open (allow but monitor for activity), to moderate (enabling certain applications or functions), to closed (deny). The tight integration of application control, users, and groups, and the ability to scan the allowed traffic for a wide range of threats minimizes the number of policies.

PAN-OS also includes attack protection capabilities, such as blocking invalid or malformed packets, IP defragmentation, Transmission Control Protocol (“TCP”) reassembly, and network traffic normalization. PAN-OS eliminates invalid and malformed packets, while TCP reassembly and IP defragmentation is performed to ensure the utmost accuracy and protection despite any attack evasion techniques.

**WildFire.** WildFire is our cloud-based malware analysis environment that offers a completely new approach to cybersecurity. Through native integration with our Next-Generation Firewall, the service brings advanced threat detection and prevention to every system deployed throughout the network, automatically sharing protections with all WildFire subscribers globally.

The service offers a unified, hybrid cloud architecture deployed via either a Palo Alto Networks run cloud, a private cloud appliance that maintains all data on the local network, or a combination of the two. This allows us to perform dynamic analysis of suspicious content in a cloud-based virtual environment to discover unknown threats, automatic creation and enforcement of best-in-class, content-based malware protections, and link detection in email, proactively blocking access to malicious websites.

Advanced attacks are not point-in-time events. Adversaries deliver attacks persistently, often using non-standard ports, protocols or encryption for subsequent attack stages. Like our Next-Generation Firewall, WildFire provides complete visibility into unknown threats within all traffic across thousands of applications, including Web traffic, email protocols (SMTP, IMAP, POP), and FTP, regardless of ports or encryption (SSL).

Once WildFire discovers a new threat, the service automatically generates protections across the attack life-cycle, blocking malicious files and command-and-control traffic. Uniquely, many of these protections are content-based, not relying on easily changed attributes such as hash, filename or URL, allowing the service to block the initial malware and future variants without any additional action or analysis. WildFire informs the protection of our other security services, blocking threats in-line through Threat Prevention (anti-malware, DNS, command-and-control), Web Security (malicious URLs in PAN-DB), and GlobalProtect (anti-malware for mobile devices).

**Traps.** Traps is our Advanced Endpoint Protection product that prevents advanced attacks originating from either exploits or malicious executables before any malicious activity can successfully run, regardless of software patches in place. If an attack attempt is made, Traps will immediately block the technique or techniques, terminate the process, and notify both the user and the administrator that an attack was thwarted. Whenever a block does occur, Traps will collect detailed forensics, including the offending process, the memory state when it was prevented, and many other details that are reported to the Endpoint Security Manager (“ESM”).

The Traps agent injects itself into each process as it is started. When an attacker attempts to exploit a software vulnerability, the Traps protection modules cause the exploit attempt to fail because Traps has already made the process impervious to those techniques. When the attempt is prevented, the Traps agent kills the process and reports all of the details to the ESM.

Traps policy is configured to protect over 100 processes—each one with dozens of proprietary exploit prevention modules (“EPMs”). However, unlike other products, Traps is not limited to protecting only those processes or applications. Our end-customers use Traps to protect all manner of processes and applications by simply adding them to the policy configuration. Processes that have been run on the endpoint automatically show up in the ESM console, making it easy to protect those processes with the click of a button. This is especially useful for those end-customers running industry-specific applications. In addition to protecting workstations, laptops, and servers, Traps can protect point-of-sale (“POS”) systems, automated teller machines (“ATMs”), supervisory control and data acquisition (“SCADA”), and any other applications from exploitation.

**Certifications.** Many of our products have been awarded Federal Information Processing Standard (“FIPS”) 140-2 Level 2, Common Criteria/National Information Assurance Partnership (“NIAP”) Evaluation Assurance Level (“EAL”) 2, Common Criteria/NIAP EAL4+, Network Equipment-Building System (“NEBS”), and ICSA Firewall certifications.

## **Research and Development**

Our research and development effort is focused on developing new hardware and software and on enhancing and improving our existing product and subscription offerings. We believe that hardware and software are both critical to expanding our leadership in the enterprise security market. Our engineering team has deep networking, endpoint, and security expertise and works closely with end-customers to identify their current and future needs. In addition to our focus on hardware and software, our research and development team is focused on research into applications and threats, which allows us to respond to the rapidly changing application and threat landscape. We supplement our own research and development effort with technologies and products that we license from third parties. We test our products thoroughly to certify and ensure interoperability with third-party hardware and software products. Our research and development expense was \$347.4 million, \$284.2 million, and \$185.8 million in fiscal 2017, 2016, and 2015, respectively.

We believe that innovation and timely development of new features and products is essential to meeting the needs of our end-customers and improving our competitive position. In February 2017, we expanded our family of firewalls with the launch of several new appliances: our PA-220, which is designed for small branch offices and remote locations; our PA-800 series, which are ideal for medium-sized networks and branch and remote office environments; our PA-5200 series, which deliver security for high throughput environments in a compact form factor; and three new VM-Series virtual firewall models, which support cloud and virtualization initiatives ranging from virtualized branch offices to data center and service provider deployments. We also delivered PAN-OS 8.0, an important software release that expands security for public and private clouds, provides new SaaS application security functionality, and also provides the capabilities to prevent the theft and abuse of stolen credentials. Additionally, in February 2017 we acquired LightCyber Ltd. (“LightCyber”), a privately-held cybersecurity company. LightCyber’s technology expands the functionality of our platform through the addition of behavioral analytics, and will be the foundation for a new future subscription offering. We also expect to release two new cloud-based subscription offerings in September 2017: our GlobalProtect cloud service subscription, which provides our Next Generation Security Platform as a cloud-based service for remote offices and mobile users; and our Logging Service subscription, which functions as the central cloud-based repository for all application data and logs, and allows end-customers to collect data without needing to plan for local processing power and storage.

We plan to continue to significantly invest in our research and development effort as we evolve and extend the capabilities of our platform. For example, in June 2017, we announced the next phase in the evolution of our Next-Generation Security Platform: our Palo Alto Networks Application Framework. Our cloud-based Application Framework will extend the capabilities of our Next-Generation Security Platform and will introduce a new SaaS consumption model that will allow our end-customers to evaluate and deploy new capabilities via security applications developed by our engineering team, as well as those built by third-party developers and other security industry vendors. Under this new model, our end-customers will be able to rapidly implement these cloud-based security applications without having to deploy or manage additional products. We expect our Application Framework to become generally available in the early 2018 calendar year, with continuous and ongoing introduction of new security applications.

## **Intellectual Property**

Our industry is characterized by the existence of a large number of patents and frequent claims and related litigation regarding patent and other intellectual property rights. In particular, leading companies in the enterprise security industry have extensive patent portfolios and are regularly involved in both offensive and defensive litigation. We continue to grow our patent portfolio and own intellectual property and related intellectual property rights around the world that relate to our products, services, research and development, and other activities, and our success depends in part upon our ability to protect our core technology and intellectual property. We file

patent applications to protect our intellectual property and believe that the duration of our issued patents is sufficient when considering the expected lives of our products.

We actively seek to protect our global intellectual property rights and to deter unauthorized use of our intellectual property by controlling access to and use of our proprietary software and other confidential information through the use of internal and external controls, including contractual protections with employees, contractors, end-customers and partners, and our software is protected by U.S. and international copyright laws. Despite our efforts to protect our intellectual property rights, our rights may not be successfully asserted in the future or may be invalidated, circumvented or challenged. In addition, the laws of various foreign countries where our offerings are distributed may not protect our intellectual property rights to the same extent as laws in the United States. See “Risk Factors-Claims by others that we infringe their proprietary technology or other rights could harm our business,” “Risk Factors-Our proprietary rights may be difficult to enforce or protect, which could enable others to copy or use aspects of our products or subscriptions without compensating us,” and “Legal Proceedings” below for additional information.

## Competition

We operate in the intensely competitive enterprise security market that is characterized by constant change and innovation. Changes in the application, threat, and technology landscape result in evolving customer requirements for the protection from threats and the safe enablement of applications. Our main competitors fall into three categories:

- large networking vendors that incorporate security features in their products, such as Cisco Systems, Inc. (“Cisco”) and Juniper Networks, Inc. (“Juniper”), or those that have acquired, or may acquire, large network and endpoint security specialist vendors and have the technical and financial resources to bring competitive solutions to the market;
- independent security vendors such as Symantec Corporation (“Symantec”), Check Point Software Technologies Ltd. (“Check Point”), Fortinet, Inc. (“Fortinet”), and FireEye, Inc. (“FireEye”) that offer a mix of network and endpoint security products; and
- small and large companies that offer point solutions and/or cloud security services that compete with some of the features present in our platform.

As our market grows, it will attract more highly specialized vendors as well as larger vendors that may continue to acquire or bundle their products more effectively.

The principal competitive factors in our market include:

- product features, reliability, performance, and effectiveness;
- product line breadth, diversity, and applicability;
- product extensibility and ability to integrate with other technology infrastructures;
- price and total cost of ownership;
- adherence to industry standards and certifications;
- strength of sales and marketing efforts; and
- brand awareness and reputation.

We believe we generally compete favorably with our competitors on the basis of these factors as a result of the features and performance of our platform, the ease of integration of our products with technological infrastructures, and the relatively low total cost of ownership of our products. However, many of our competitors have substantially greater financial, technical, and other resources, greater name recognition, larger sales and marketing budgets, broader distribution, more diversified product lines, and larger and more mature intellectual property portfolios.

## Sales, Customer Support and Marketing

**Customers.** Our end-customers are predominantly medium to large enterprises, service providers, and government entities. Our end-customers operate in a variety of industries, including education, energy, financial services, government entities, healthcare, Internet and media, manufacturing, public sector, and telecommunications. Our end-customers deploy our platform for a variety of security functions across a variety of deployment scenarios. Typical deployment scenarios include the enterprise perimeter, the enterprise data center, and the distributed enterprise perimeter. Our end-customer deployments typically involve at least one pair of our products along with one or more of our subscriptions, depending on size, security needs and requirements, and network complexity. As of July 31, 2017, we had more than 42,500 end-customers worldwide. No single end-customer accounted for more than 10% of our total revenue in fiscal 2017, 2016, or 2015.

**Distribution.** We primarily sell our products and subscription and support offerings to end-customers through our channel partners utilizing a two-tier, indirect fulfillment model whereby we sell our products and subscription and support offerings to our distributors, which, in turn, sell to our resellers, which then sell to our end-customers. Sales are subject to our standard, non-exclusive distributor agreement, which provides for an initial term of one year, one-year renewal terms, termination by us with 30-90 days written notice prior to the renewal date, and payment to us from the channel partner within 30-45 calendar days of the date we issue an invoice for such sales. For fiscal 2017, 65.7% of our total revenue was derived from sales to three distributors.

We also sell our VM-Series virtual firewalls directly to end-customers through Amazon's AWS Marketplace and Microsoft's Azure Marketplace under a usage-based licensing model.

**Sales.** Our sales organization is responsible for large-account acquisition and overall market development, which includes the management of the relationships with our channel partners, working with our channel partners in winning and supporting end-customers through a direct-touch approach, and acting as the liaison between our end-customers and our marketing and product development organizations. We expect to continue to grow our sales headcount in all of our principal markets and expand our presence into countries where we currently do not have a direct sales presence.

Our sales organization is supported by sales engineers with responsibility for pre-sales technical support, solutions engineering for our end-customers, and technical training for our channel partners.

**Channel Program.** Our NextWave Channel Partner program is focused on building in-depth relationships with solutions-oriented distributors and resellers that have strong security expertise. The program rewards these partners based on a number of attainment goals, as well as provides them access to marketing funds, technical and sales training, and support. To ensure optimal productivity, we operate a formal accreditation program for our channel partners' sales and technical professionals. As of July 31, 2017, we had more than 4,400 channel partners.

**Customer Support.** Our customer support organization is responsible for delivering support, professional, and educational services directly to our channel partners and to end-customers. We leverage the capabilities of our channel partners and train them in the delivery of support, professional, and educational services to ensure these services are locally delivered. We believe that a broad range of support services is essential to the successful customer deployment and ongoing support of our products, and we have hired support engineers with proven experience to provide those services.

**Marketing.** Our marketing is focused on building our brand reputation and the market awareness of our platform and driving pipeline and end-customer demand. Our marketing team consists primarily of product marketing, programs marketing, field marketing, channel marketing, and public relations functions. Marketing activities include pipeline development through demand generation, social media and advertising programs, managing the corporate web site and partner portal, trade shows and conferences, press, analyst, and customer relations, and customer awareness. Every year we organize our end-customer conference "Ignite." We also publish major market research papers such as the "Application Usage and Threat Report," which are based on the application and cyberthreat landscape of our end-customers. These activities and tools benefit both our direct and indirect channels and are available at no cost to our channel partners.



**Backlog.** Orders for subscription and support offerings for multiple years are generally billed upfront shortly after fulfillment of an order and are included in deferred revenue. Timing of revenue recognition for subscription and support offerings may vary depending on the contractual period or when the subscription and support offerings are rendered. Products are shipped and billed shortly after receipt of an order. The majority of our product revenue comes from orders that are received and shipped in the same quarter. As such, we do not believe that our product backlog at any particular time is meaningful and it is not necessarily indicative of our future operating results.

**Seasonality.** Our business is affected by seasonal fluctuations in customer spending patterns. We have begun to see seasonal patterns in our business, which we expect to become more pronounced as we continue to grow, with our strongest sequential revenue growth occurring in our fiscal second and fourth quarters.

## **Manufacturing**

We outsource the manufacturing of our security products to various manufacturing partners, which include our electronics manufacturing services provider (“EMS provider”) and original design manufacturers. This approach allows us to reduce our costs as it reduces our manufacturing overhead and inventory and also allows us to adjust more quickly to changing end-customer demand. Our EMS provider is Flextronics International, Ltd. (“Flex”), who assembles our products using design specifications, quality assurance programs, and standards that we establish, and procures components and assembles our products based on our demand forecasts. These forecasts represent our estimates of future demand for our products based upon historical trends and analysis from our sales and product management functions as adjusted for overall market conditions.

The component parts within our products are either sourced by our manufacturing partners or by various component suppliers. We do not have any long-term manufacturing contracts that guarantee us any fixed capacity or pricing, which could increase our exposure to supply shortages or price fluctuations related to raw materials.

## **Employees**

As of July 31, 2017, we had 4,562 employees. Competition for qualified personnel in our industry is intense, and we believe that our future success depends in part on our continued ability to hire, motivate, and retain such personnel.

## **Segment and Geographic Information**

We are organized and operate in a single reportable segment, with 70.2% of our total revenue in fiscal 2017 from the Americas, 18.2% from Europe, the Middle East, and Africa (“EMEA”), and 11.6% from Asia Pacific and Japan (“APAC”). Refer to Note 16. Segment Information of Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report on Form 10-K for more information about segments and revenue and assets by geographic region.

## **Available Information**

Our website is located at [www.paloaltonetworks.com](http://www.paloaltonetworks.com), and our investor relations website is located at [investors.paloaltonetworks.com](http://investors.paloaltonetworks.com). Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to reports filed or furnished pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), are available free of charge on the Investors portion of our web site as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission (“SEC”). We also provide a link to the section of the SEC’s website at [www.sec.gov](http://www.sec.gov) that has all of our public filings, including Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, all amendments to those reports, our Proxy Statements, and other ownership related filings. Further, a copy of this Annual Report on Form 10-K is located at the SEC’s Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Information on the operation of the Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330.

We also use our investor relations website as a channel of distribution for important company information. For example, webcasts of our earnings calls and certain events we participate in or host with members of the investment community are on our investor relations website. Additionally, we announce investor information, including news and commentary about our business and financial performance, SEC filings, notices of investor events, and our press and earnings releases, on our investor relations website. Investors and others can receive notifications of new information posted on our investor relations website in real time by signing up for email alerts and RSS feeds. Further corporate governance information, including our corporate governance guidelines, board committee charters, and code of conduct, is also available on our investor relations website under the heading “Governance.” The contents of our websites are not incorporated by reference into this Annual Report on Form 10-K or in any other report or document we file with the SEC, and any references to our websites are intended to be inactive textual references only.

## **ITEM 1A. RISK FACTORS**

*Our operations and financial results are subject to various risks and uncertainties including those described below. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties that we are unaware of, or that we currently believe are not material, also may become important factors that affect us. If any of the following risks or others not specified below materialize, our business, financial condition, and operating results could be materially adversely affected and the market price of our common stock could decline.*

### **Risks Related to Our Business and Our Industry**

***Our business and operations have experienced rapid growth in recent periods, and if we do not effectively manage any future growth or are unable to improve our systems, processes, and controls, our operating results could be adversely affected.***

We have experienced rapid growth and increased demand for our products and subscriptions over the last few years. As a result, our employee headcount and number of end-customers have increased significantly, and we expect both to continue to grow over the next year. For example, from the end of fiscal 2016 to the end of fiscal 2017, our headcount increased from 3,795 to 4,562 employees, and our number of end-customers increased from approximately 34,000 to more than 42,500. In addition, as we have grown, we have increasingly managed more complex deployments of our products and subscriptions with larger end-customers. The growth and expansion of our business and product, subscription, and support offerings places a significant strain on our management, operational, and financial resources. To manage any future growth effectively, we must continue to improve and expand our information technology and financial infrastructure, our operating and administrative systems, and our ability to manage headcount, capital, and processes in an efficient manner.

We may not be able to successfully implement or scale improvements to our systems, processes, and controls in an efficient or timely manner. In addition, our existing systems, processes, and controls may not prevent or detect all errors, omissions, or fraud. We may also experience difficulties in managing improvements to our systems, processes, and controls or in connection with third-party software licensed to help us with such improvements. Any future growth would add complexity to our organization and require effective coordination throughout our organization. Failure to manage any future growth effectively could result in increased costs, disrupt our existing end-customer relationships, reduce demand for or limit us to smaller deployments of our platform, or harm our business performance and operating results.

***Our operating results may vary significantly from period to period and be unpredictable, which could cause the market price of our common stock to decline.***

Our operating results, in particular, our revenues, gross margins, operating margins, and operating expenses, have historically varied from period to period, and even though we have experienced growth, we expect variation

to continue as a result of a number of factors, many of which are outside of our control and may be difficult to predict, including:

- our ability to attract and retain new end-customers or sell additional products and subscriptions to our existing end-customers;
- the budgeting cycles, seasonal buying patterns, and purchasing practices of end-customers;
- changes in end-customer, distributor or reseller requirements, or market needs;
- price competition;
- the timing and success of new product and service introductions by us or our competitors or any other change in the competitive landscape of our industry, including consolidation among our competitors or end-customers and strategic partnerships entered into by and between our competitors;
- changes in the mix of our products, subscriptions, and support, including changes in multi-year subscriptions and support;
- our ability to successfully and continuously expand our business domestically and internationally;
- changes in the growth rate of the enterprise security market;
- deferral of orders from end-customers in anticipation of new products or product enhancements announced by us or our competitors;
- the timing and costs related to the development or acquisition of technologies or businesses or strategic partnerships;
- lack of synergy or the inability to realize expected synergies, resulting from acquisitions or strategic partnerships;
- our inability to execute, complete or integrate efficiently any acquisitions that we may undertake;
- increased expenses, unforeseen liabilities, or write-downs and any impact on our operating results from any acquisitions we consummate;
- our ability to increase the size and productivity of our distribution channel;
- decisions by potential end-customers to purchase security solutions from larger, more established security vendors or from their primary network equipment vendors;
- changes in end-customer penetration, attach, and renewal rates for our subscriptions;
- timing of revenue recognition and revenue deferrals;
- our ability to manage production and manufacturing related costs, global customer service organization costs, inventory excess and obsolescence costs, and warranty costs;
- insolvency or credit difficulties confronting our end-customers, which could adversely affect their ability to purchase or pay for our products and subscription and support offerings, or confronting our key suppliers, including our sole source suppliers, which could disrupt our supply chain;
- any disruption in our channel or termination of our relationships with important channel partners, including as a result of consolidation among distributors and resellers of security solutions;
- our inability to fulfill our end-customers' orders due to supply chain delays or events that impact our manufacturers or their suppliers;
- the cost and potential outcomes of litigation, which could have a material adverse effect on our business;
- seasonality or cyclical fluctuations in our markets;

- future accounting pronouncements or changes in our accounting policies, including the potential impact of the adoption and implementation of the Financial Accounting Standards Board’s new standard regarding revenue recognition;
- increases or decreases in our expenses or fluctuations in our sales cycle caused by fluctuations in foreign currency exchange rates, as an increasing amount of our expenses is incurred and paid in currencies other than the U.S. dollar;
- political, economic and social instability, such as those caused by the upcoming elections in Europe, the recent referendum in which voters in the United Kingdom (the “U.K.”) approved an exit from the European Union (the “E.U.”), continued hostilities in the Middle East, terrorist activities, and any disruption these events may cause to the broader global industrial economy; and
- general macroeconomic conditions, both domestically and in our foreign markets that could impact some or all regions where we operate.

Any one of the factors above, or the cumulative effect of some of the factors referred to above, may result in significant fluctuations in our financial and other operating results. This variability and unpredictability could result in our failure to meet our revenue, margin, or other operating result expectations or those of securities analysts or investors for a particular period. If we fail to meet or exceed such expectations for these or any other reasons, the market price of our common stock could fall substantially, and we could face costly lawsuits, including securities class action suits.

***Uncertain or weakened global economic conditions could have an adverse effect on our business and operating results.***

We operate globally and as a result our business and revenues are impacted by global macroeconomic conditions. The global macroeconomic environment has been and may continue to be inconsistent and challenging due to instability in the global credit markets, the current economic challenges in China, falling demand for oil and other commodities, uncertainties regarding the effects of the “Brexit” decision, uncertainties related to changes in public policies such as domestic and international regulations, taxes, or international trade agreements, geopolitical turmoil and other disruptions to global and regional economies and markets. As a result, any continued or further uncertainty, weakness or deterioration in global macroeconomic and market conditions may cause our end-customers to modify spending priorities or delay purchasing decisions, and result in lengthened sales cycles, all of which could harm our business and operating results.

***Our revenue growth rate in recent periods may not be indicative of our future performance.***

We have experienced revenue growth rates of 27.8% and 48.5% in fiscal 2017 and fiscal 2016, respectively. Our revenue for any prior quarterly or annual period should not be relied upon as an indication of our future revenue or revenue growth for any future period. If we are unable to maintain consistent revenue or revenue growth, the market price of our common stock could be volatile, and it may be difficult for us to achieve and maintain profitability or maintain or increase cash flow on a consistent basis.

***We have a history of losses, anticipate increasing our operating expenses in the future, and may not be able to achieve or maintain profitability or maintain or increase cash flow on a consistent basis, which could cause our business, financial condition, and operating results to suffer.***

Other than fiscal 2012, we have incurred losses in all fiscal years since our inception. As a result, we had an accumulated deficit of \$836.7 million at July 31, 2017. We anticipate that our operating expenses will continue to increase in the foreseeable future as we continue to grow our business. Our growth efforts may prove more expensive than we currently anticipate, and we may not succeed in increasing our revenues sufficiently, or at all, to offset increasing expenses. Revenue growth may slow or revenue may decline for a number of possible reasons, including slowing demand for our products or subscriptions, increasing competition, a decrease in the growth of our overall market, or a failure to capitalize on growth opportunities. Any failure to increase our revenue as we grow our business could prevent us from achieving or maintaining profitability or maintaining or

increasing cash flow on a consistent basis. In addition, we may have difficulty achieving profitability under U.S. generally accepted accounting principles (“GAAP”) due to share-based compensation expense and other non-cash charges. If we are unable to navigate these challenges as we encounter them, our business, financial condition, and operating results may suffer.

***If we are unable to sell additional product, subscription, and support offerings to our end-customers, our future revenue and operating results will be harmed.***

Our future success depends, in part, on our ability to expand the deployment of our platform with existing end-customers. This may require increasingly sophisticated and costly sales efforts that may not result in additional sales. The rate at which our end-customers purchase additional products, subscriptions, and support depends on a number of factors, including the perceived need for additional security products, including subscription and support offerings, as well as general economic conditions. Further, existing end-customers have no contractual obligation to and may not renew their subscription and support contracts after the completion of their initial contract period. Our end-customers’ renewal rates may decline or fluctuate as a result of a number of factors, including their satisfaction with our subscriptions and our support offerings, the frequency and severity of subscription outages, our product uptime or latency, and the pricing of our, or competing, subscriptions. Additionally, our end-customers may renew their subscription and support agreements for shorter contract lengths or on other terms that are less economically beneficial to us. We also cannot be certain that our end-customers will renew their subscription and support agreements. If our efforts to sell additional products and subscriptions to our end-customers are not successful or our end-customers do not renew their subscription and support agreements or renew on less favorable terms, our revenues may grow more slowly than expected or decline.

***We face intense competition in our market, especially from larger, well-established companies, and we may lack sufficient financial or other resources to maintain or improve our competitive position.***

The market for enterprise security products is intensely competitive, and we expect competition to increase in the future from established competitors and new market entrants. Our main competitors fall into three categories:

- large companies that incorporate security features in their products, such as Cisco and Juniper, or those that have acquired, or may acquire, large network and endpoint security vendors and have the technical and financial resources to bring competitive solutions to the market;
- independent security vendors, such as Symantec, Check Point, Fortinet, and FireEye, that offer a mix of network and endpoint security products; and
- small and large companies that offer point solutions and/or cloud security services that compete with some of the features present in our platform.

Many of our existing competitors have, and some of our potential competitors could have, substantial competitive advantages such as:

- greater name recognition and longer operating histories;
- larger sales and marketing budgets and resources;
- broader distribution and established relationships with distribution partners and end-customers;
- greater customer support resources;
- greater resources to make strategic acquisitions or enter into strategic partnerships;
- lower labor and development costs;
- larger and more mature intellectual property portfolios; and
- substantially greater financial, technical, and other resources.

In addition, some of our larger competitors have substantially broader and more diverse product and services offerings, which may make them less susceptible to downturns in a particular market and allow them to

leverage their relationships based on other products or incorporate functionality into existing products to gain business in a manner that discourages users from purchasing our products and subscriptions, including through selling at zero or negative margins, offering concessions, product bundling, or closed technology platforms. Many of our smaller competitors that specialize in providing protection from a single type of security threat are often able to deliver these specialized security products to the market more quickly than we can.

Organizations that use legacy products and services may believe that these products and services are sufficient to meet their security needs or that our platform only serves the needs of a portion of the enterprise security market. Accordingly, these organizations may continue allocating their information technology budgets for legacy products and services and may not adopt our security platform. Further, many organizations have invested substantial personnel and financial resources to design and operate their networks and have established deep relationships with other providers of networking and security products. As a result, these organizations may prefer to purchase from their existing suppliers rather than add or switch to a new supplier such as us regardless of product performance, features, or greater services offerings or may be more willing to incrementally add solutions to their existing security infrastructure from existing suppliers than to replace it wholesale with our solutions.

Conditions in our market could change rapidly and significantly as a result of technological advancements, partnering or acquisitions by our competitors, or continuing market consolidation. New start-up companies that innovate and large competitors that are making significant investments in research and development may invent similar or superior products and technologies that compete with our products and subscriptions. Some of our competitors have made or could make acquisitions of businesses that may allow them to offer more directly competitive and comprehensive solutions than they had previously offered and adapt more quickly to new technologies and end-customer needs. Our current and potential competitors may also establish cooperative relationships among themselves or with third parties that may further enhance their resources.

These competitive pressures in our market or our failure to compete effectively may result in price reductions, fewer orders, reduced revenue and gross margins, and loss of market share. Any failure to meet and address these factors could seriously harm our business and operating results.

***A network or data security incident may allow unauthorized access to our network or data, harm our reputation, create additional liability and adversely impact our financial results.***

Increasingly, companies are subject to a wide variety of attacks on their networks on an ongoing basis. In addition to traditional computer “hackers,” malicious code (such as viruses and worms), phishing attempts, employee theft or misuse, and denial of service attacks, sophisticated nation-state and nation-state supported actors now engage in intrusions and attacks (including advanced persistent threat intrusions) and add to the risks to our internal networks and the information they store and process. Despite significant efforts to create security barriers to such threats, it is virtually impossible for us to entirely mitigate these risks. Furthermore, as a well-known provider of security solutions, we may be a more attractive target for such attacks. A breach in our data security could compromise our networks or networks secured by our products and subscriptions, creating system disruptions or slowdowns and exploiting security vulnerabilities of our products, and the information stored on our networks could be accessed, publicly disclosed, altered, lost, or stolen, which could subject us to liability and cause us financial harm. Although we have not yet experienced significant damages from unauthorized access by a third party of our internal network, any actual or perceived breach of network security in our internal systems could result in damage to our reputation, negative publicity, loss of channel partners, end-customers and sales, loss of competitive advantages over our competitors, increased costs to remedy any problems, and costly litigation. Any of these negative outcomes could adversely impact the market perception of our products and subscriptions and investor confidence in our company and could seriously harm our business or operating results.

***Reliance on shipments at the end of the quarter could cause our revenue for the applicable period to fall below expected levels.***

As a result of end-customer buying patterns and the efforts of our sales force and channel partners to meet or exceed their sales objectives, we have historically received a substantial portion of sales orders and generated a substantial portion of revenue during the last few weeks of each fiscal quarter. If expected revenue at the end of

any fiscal quarter is delayed for any reason, including the failure of anticipated purchase orders to materialize (particularly for large enterprise end-customers with lengthy sales cycles), our logistics partners' inability to ship products prior to fiscal quarter-end to fulfill purchase orders received near the end of the fiscal quarter, our failure to manage inventory to meet demand, any failure of our systems related to order review and processing, or any delays in shipments based on trade compliance requirements (including new compliance requirements imposed by new or renegotiated trade agreements), revenue could fall below our expectations and the estimates of analysts for that quarter, which could adversely impact our business and operating results and cause a decline in the market price of our common stock.

***Seasonality may cause fluctuations in our revenue.***

We believe there are significant seasonal factors that may cause our second and fourth fiscal quarters to record greater revenue sequentially than our first and third fiscal quarters. We believe that this seasonality results from a number of factors, including:

- end-customers with a December 31 fiscal year-end choosing to spend remaining unused portions of their discretionary budgets before their fiscal year-end, which potentially results in a positive impact on our revenue in our second fiscal quarter;
- our sales compensation plans, which are typically structured around annual quotas and commission rate accelerators, which potentially results in a positive impact on our revenue in our fourth fiscal quarter;
- seasonal reductions in business activity during August in the United States, Europe and certain regions, which potentially results in a negative impact on our first fiscal quarter revenue; and
- the timing of end-customer budget planning at the beginning of the calendar year, which can result in a delay in spending at the beginning of the calendar year potentially resulting in a negative impact on our revenue in our third fiscal quarter.

As we continue to grow, seasonal or cyclical variations in our operations may become more pronounced, and our business, operating results and financial position may be adversely affected.

***If we are unable to hire, integrate, train, retain, and motivate qualified personnel and senior management, our business could suffer.***

Our future success depends, in part, on our ability to continue to attract, integrate, train, and retain qualified and highly skilled personnel. We are substantially dependent on the continued service of our existing engineering personnel because of the complexity of our platform. Additionally, any failure to hire, train, and adequately incentivize our sales personnel or the inability of our recently hired sales personnel to effectively ramp to target productivity levels could negatively impact our growth and operating margins. Competition for highly skilled personnel, particularly in engineering, is often intense, especially in the San Francisco Bay Area, where we have a substantial presence and need for such personnel. Additionally, potential changes in U.S. immigration policy may make it difficult to renew or obtain visas for any highly skilled personnel that we have hired or are actively recruiting.

In addition, the industry in which we operate generally experiences high employee attrition. Although we have entered into employment offer letters with our key personnel, these agreements have no specific duration and constitute at-will employment. We do not maintain key person life insurance policies on any of our employees. The loss of one or more of our key employees could seriously harm our business. If we are unable to attract, integrate, train, or retain the qualified and highly skilled personnel required to fulfill our current or future needs, our business, financial condition, and operating results could be harmed.

Our future performance also depends on the continued services and continuing contributions of our senior management to execute on our business plan and to identify and pursue new opportunities and product innovations. The loss of services of senior management or the ineffective management of any leadership transitions, especially within our sales organization, could significantly delay or prevent the achievement of our development and strategic objectives, which could adversely affect our business, financial condition, and operat-

ing results. Additionally, our chief financial officer recently advised us of his intent to retire from his position and if we are unable to timely attract, identify, hire and integrate a successor, our business and operating results could be harmed.

Further, we believe that a critical contributor to our success and our ability to retain highly skilled personnel has been our corporate culture, which we believe fosters innovation, teamwork, passion for end-customers, focus on execution, and the facilitation of critical knowledge transfer and knowledge sharing. As we grow and change, we may find it difficult to maintain these important aspects of our corporate culture. Any failure to preserve our culture as we grow could limit our ability to innovate and could negatively affect our ability to retain and recruit personnel, continue to perform at current levels or execute on our business strategy.

***If we are not successful in executing our strategy to increase sales of our products and subscriptions to new and existing medium and large enterprise end-customers, our operating results may suffer.***

Our growth strategy is dependent, in part, upon increasing sales of our products to new and existing medium and large enterprise end-customers. Sales to these end-customers involve risks that may not be present, or that are present to a lesser extent, with sales to smaller entities. These risks include:

- competition from larger competitors, such as Cisco, Check Point, and Juniper, that traditionally target larger enterprises, service providers, and government entities and that may have pre-existing relationships or purchase commitments from those end-customers;
- increased purchasing power and leverage held by large end-customers in negotiating contractual arrangements with us;
- more stringent requirements in our worldwide support contracts, including stricter support response times and penalties for any failure to meet support requirements; and
- longer sales cycles, in some cases over 12 months, and the associated risk that substantial time and resources may be spent on a potential end-customer that elects not to purchase our products and subscriptions.

At the beginning of fiscal 2017, we experienced execution challenges with respect to certain elements of our go-to-market strategy. While we have and will continue to implement changes to our go-to-market strategy that are designed to address these challenges, such changes may be difficult to implement and result in further disruptions to our sales organization or, once implemented, fail to resolve these challenges, which could impact our results of operations. In addition, product purchases by large enterprises are frequently subject to budget constraints, multiple approvals, and unplanned administrative, processing, and other delays. Finally, large enterprises typically have longer implementation cycles, require greater product functionality and scalability and a broader range of services, demand that vendors take on a larger share of risks, sometimes require acceptance provisions that can lead to a delay in revenue recognition, and expect greater payment flexibility from vendors. All of these factors can add further risk to business conducted with these end-customers. If we fail to realize an expected sale from a large end-customer in a particular quarter or at all, our business, operating results, and financial condition could be materially and adversely affected.

***We rely on revenue from subscription and support offerings, and because we recognize revenue from subscription and support over the term of the relevant service period, downturns or upturns in sales of these subscription and support offerings are not immediately reflected in full in our operating results.***

Subscription and support revenue accounts for a significant portion of our revenue, comprising 59.7% of total revenue in fiscal 2017, 51.3% of total revenue in fiscal 2016, and 46.9% of total revenue in fiscal 2015. Sales of new or renewal subscription and support contracts may decline and fluctuate as a result of a number of factors, including end-customers' level of satisfaction with our products and subscriptions, the prices of our products and subscriptions, the prices of products and services offered by our competitors, and reductions in our end-customers' spending levels. If our sales of new or renewal subscription and support contracts decline, our total revenue and revenue growth rate may decline and our business will suffer. In addition, we recognize subscription and support revenue monthly over the term of the relevant service period, which is typically one to five



years. As a result, much of the subscription and support revenue we report each fiscal quarter is the recognition of deferred revenue from subscription and support contracts entered into during previous fiscal quarters. Consequently, a decline in new or renewed subscription or support contracts in any one fiscal quarter will not be fully or immediately reflected in revenue in that fiscal quarter but will negatively affect our revenue in future fiscal quarters. Also, it is difficult for us to rapidly increase our subscription and support revenue through additional subscription and support sales in any period, as revenue from new and renewal subscription and support contracts must be recognized over the applicable service period.

***Defects, errors, or vulnerabilities in our products, subscriptions, or support offerings, the failure of our products or subscriptions to block a virus or prevent a security breach, misuse of our products, or risks of product liability claims could harm our reputation and adversely impact our operating results.***

Because our products and subscriptions are complex, they have contained and may contain design or manufacturing defects or errors that are not detected until after their commercial release and deployment by our end-customers. For example, from time to time, certain of our end-customers have reported defects in our products related to performance, scalability, and compatibility. Additionally, defects may cause our products or subscriptions to be vulnerable to security attacks, cause them to fail to help secure networks, or temporarily interrupt end-customers' networking traffic. Because the techniques used by computer hackers to access or sabotage networks change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques and provide a solution in time to protect our end-customers' networks. Furthermore, as a well-known provider of security solutions, our networks, products, including cloud-based technology, and subscriptions could be targeted by attacks specifically designed to disrupt our business and harm our reputation. In addition, defects or errors in our subscription updates or our products could result in a failure of our subscriptions to effectively update end-customers' hardware and cloud-based products. Our data centers and networks may experience technical failures and downtime, may fail to distribute appropriate updates, or may fail to meet the increased requirements of a growing installed end-customer base, any of which could temporarily or permanently expose our end-customers' networks, leaving their networks unprotected against the latest security threats. Moreover, our products must interoperate with our end-customers' existing infrastructure, which often have different specifications, utilize multiple protocol standards, deploy products from multiple vendors, and contain multiple generations of products that have been added over time. As a result, when problems occur in a network, it may be difficult to identify the sources of these problems.

The occurrence of any such problem in our products and subscriptions, whether real or perceived, could result in:

- expenditure of significant financial and product development resources in efforts to analyze, correct, eliminate, or work-around errors or defects or to address and eliminate vulnerabilities;
- loss of existing or potential end-customers or channel partners;
- delayed or lost revenue;
- delay or failure to attain market acceptance;
- an increase in warranty claims compared with our historical experience, or an increased cost of servicing warranty claims, either of which would adversely affect our gross margins; and
- litigation, regulatory inquiries, or investigations that may be costly and harm our reputation.

Further, our products and subscriptions may be misused by end-customers or third parties that obtain access to our products and subscriptions. For example, our products and subscriptions could be used to censor private access to certain information on the Internet. Such use of our products and subscriptions for censorship could result in negative press coverage and negatively affect our reputation.

The limitation of liability provisions in our standard terms and conditions of sale may not fully or effectively protect us from claims as a result of federal, state, or local laws or ordinances, or unfavorable judicial decisions in the United States or other countries. The sale and support of our products and subscriptions also entails the risk of product liability claims. Although we may be indemnified by our third-party manufacturers for prod-

uct liability claims arising out of manufacturing defects, because we control the design of our products and subscriptions, we may not be indemnified for product liability claims arising out of design defects. We maintain insurance to protect against certain claims associated with the use of our products and subscriptions, but our insurance coverage may not adequately cover any claim asserted against us. In addition, even claims that ultimately are unsuccessful could result in our expenditure of funds in litigation, divert management's time and other resources, and harm our reputation.

***False detection of applications, viruses, spyware, vulnerability exploits, data patterns, or URL categories could adversely affect our business.***

Our classifications of application type, virus, spyware, vulnerability exploits, data, or URL categories may falsely detect applications, content, or threats that do not actually exist. This risk is heightened by the inclusion of a "heuristics" feature in our products and subscriptions, which attempts to identify applications and other threats not based on any known signatures but based on characteristics or anomalies which indicate that a particular item may be a threat. These false positives may impair the perceived reliability of our products and subscriptions and may therefore adversely impact market acceptance of our products and subscriptions. If our products and subscriptions restrict important files or applications based on falsely identifying them as malware or some other item that should be restricted, this could adversely affect end-customers' systems and cause material system failures. Any such false identification of important files or applications could result in damage to our reputation, negative publicity, loss of channel partners, end-customers and sales, increased costs to remedy any problem, and costly litigation.

***We rely on our channel partners to sell substantially all of our products, including subscriptions and support, and if these channel partners fail to perform, our ability to sell and distribute our products and subscriptions will be limited, and our operating results will be harmed.***

Substantially all of our revenue is generated by sales through our channel partners, including distributors and resellers. We provide our channel partners with specific training and programs to assist them in selling our products, including subscriptions and support offerings, but there can be no assurance that these steps will be utilized or effective. In addition, our channel partners may be unsuccessful in marketing, selling, and supporting our products and subscriptions. We may not be able to incentivize these channel partners to sell our products and subscriptions to end-customers and, in particular, to large enterprises. These channel partners may also have incentives to promote our competitors' products and may devote more resources to the marketing, sales, and support of competitive products. Our agreements with our channel partners may generally be terminated for any reason by either party with advance notice prior to each annual renewal date. We cannot be certain that we will retain these channel partners or that we will be able to secure additional or replacement channel partners. In addition, any new channel partner requires extensive training and may take several months or more to achieve productivity. Our channel partner sales structure could subject us to lawsuits, potential liability, and reputational harm if, for example, any of our channel partners misrepresent the functionality of our products or subscriptions to end-customers or violate laws or our corporate policies. If we fail to effectively manage our sales channels or channel partners, our ability to sell our products and subscriptions and operating results will be harmed.

***If we do not accurately predict, prepare for, and respond promptly to the rapidly evolving technological and market developments and successfully manage product and subscription introductions and transitions to meet changing end-customer needs in the enterprise security market, our competitive position and prospects will be harmed.***

The enterprise security market has grown quickly and is expected to continue to evolve rapidly. Moreover, many of our end-customers operate in markets characterized by rapidly changing technologies and business plans, which require them to add numerous network access points and adapt increasingly complex enterprise networks, incorporating a variety of hardware, software applications, operating systems, and networking protocols. If we fail to accurately predict end-customers' changing needs and emerging technological trends in the enterprise security industry, including in the areas of mobility, virtualization, cloud computing, and software defined networks ("SDN"), our business could be harmed. The technology in our platform is especially complex

because it needs to effectively identify and respond to new and increasingly sophisticated methods of attack, while minimizing the impact on network performance. Additionally, some of our new platform features and related platform enhancements may require us to develop new hardware architectures that involve complex, expensive, and time-consuming research and development processes. The development of our platform is difficult and the timetable for commercial release and availability is uncertain as there can be long time periods between releases and availability of new platform features. If we experience unanticipated delays in the availability of new products, platform features, and subscriptions, and fail to meet customer expectations for such availability, our competitive position and business prospects will be harmed.

Additionally, we must commit significant resources to developing new platform features before knowing whether our investments will result in products, subscriptions, and platform features the market will accept. The success of new platform features depends on several factors, including appropriate new product definition, differentiation of new products, subscriptions, and platform features from those of our competitors, and market acceptance of these products, services and platform features. Moreover, successful new product introduction and transition depends on a number of factors including, our ability to manage the risks associated with new product production ramp-up issues, the availability of application software for new products, the effective management of purchase commitments and inventory, the availability of products in appropriate quantities and costs to meet anticipated demand, and the risk that new products may have quality or other defects or deficiencies in the early stages of introduction. There can be no assurance that we will successfully identify opportunities for new products and subscriptions, develop and bring new products and subscriptions to market in a timely manner, or achieve market acceptance of our products and subscriptions, or that products, subscriptions, and technologies developed by others will not render our products, subscriptions, or technologies obsolete or noncompetitive.

***Our current research and development efforts may not produce successful products, subscriptions, or platform features that result in significant revenue, cost savings or other benefits in the near future, if at all.***

Developing our products, subscriptions, platform features, and related enhancements is expensive. Our investments in research and development may not result in significant design improvements, marketable products, subscriptions, or platform features, or may result in products, subscriptions, or platform features that are more expensive than anticipated. Additionally, we may not achieve the cost savings or the anticipated performance improvements we expect, and we may take longer to generate revenue, or generate less revenue, than we anticipate. Our future plans include significant investments in research and development and related product and subscription opportunities. We believe that we must continue to dedicate a significant amount of resources to our research and development efforts to maintain our competitive position. However, we may not receive significant revenue from these investments in the near future, if at all, or these investments may not yield the expected benefits, either of which could adversely affect our business and operating results.

***Because we depend on manufacturing partners to build and ship our products, we are susceptible to manufacturing and logistics delays and pricing fluctuations that could prevent us from shipping customer orders on time, if at all, or on a cost-effective basis, which may result in the loss of sales and end-customers.***

We depend on manufacturing partners, primarily a subsidiary of Flex, our EMS provider, as sole source manufacturers for our product lines. Our reliance on these manufacturing partners reduces our control over the manufacturing process and exposes us to risks, including reduced control over quality assurance, product costs, product supply, timing and transportation risk. Our products are primarily manufactured by our manufacturing partners at facilities located in the United States. Over time, we intend to decrease the portion of our products that are manufactured outside the United States. The remaining portion of our products that are manufactured outside the United States may subject us to additional logistical risks or risks associated with complying with local rules and regulations in foreign countries. Significant changes to existing international trade agreements could lead to manufacturing or logistics disruption resulting from import delays or the imposition of increased tariffs on our manufacturing partners which could severely impair our ability to fulfill orders.

In addition, we are subject to requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”) to diligence, disclose, and report whether or not our products contain minerals originating from the Democratic Republic of the Congo and adjoining countries, or conflict minerals.

Although the SEC has recently provided guidance with respect to a portion of the conflict minerals filing requirements that may somewhat reduce our reporting practices, we have incurred and expect to incur additional costs to comply with these disclosure requirements, including costs related to determining the source of any of the relevant minerals and metals used in our products. These requirements could adversely affect the sourcing, availability, and pricing of minerals used in the manufacture of semiconductor devices or other components used in our products. We may also encounter end-customers who require that all of the components of our products be certified as conflict free. If we are not able to meet this requirement, such end-customers may choose not to purchase our products.

Our manufacturing partners typically fulfill our supply requirements on the basis of individual orders. We do not have long-term contracts with these manufacturers that guarantee capacity, the continuation of particular pricing terms, or the extension of credit limits. Accordingly, they are not obligated to continue to fulfill our supply requirements and the prices we pay for manufacturing services could be increased on short notice. Our contract with Flex permits them to terminate the agreement for their convenience, subject to prior notice requirements. If we are required to change manufacturing partners, our ability to meet our scheduled product deliveries to our end-customers could be adversely affected, which could cause the loss of sales to existing or potential end-customers, delayed revenue or an increase in our costs which could adversely affect our gross margins. Any production interruptions for any reason, such as a natural disaster, epidemic, capacity shortages, or quality problems, at one of our manufacturing partners would negatively affect sales of our product lines manufactured by that manufacturing partner and adversely affect our business and operating results.

***Managing the supply of our products and product components is complex. Insufficient supply and inventory may result in lost sales opportunities or delayed revenue, while excess inventory may harm our gross margins.***

Our manufacturing partners procure components and build our products based on our forecasts, and we generally do not hold inventory for a prolonged period of time. These forecasts are based on estimates of future demand for our products, which are in turn based on historical trends and analyses from our sales and product management organizations, adjusted for overall market conditions. In order to reduce manufacturing lead times and plan for adequate component supply, from time to time we may issue forecasts for components and products that are non-cancelable and non-returnable.

Our inventory management systems and related supply chain visibility tools may be inadequate to enable us to forecast accurately and effectively manage supply of our products and product components. If we ultimately determine that we have excess supply, we may have to reduce our prices and write-down inventory, which in turn could result in lower gross margins. If our actual component usage and product demand are lower than the forecast we provide to our manufacturing partners, we accrue for losses on manufacturing commitments in excess of forecasted demand. Alternatively, insufficient supply levels may lead to shortages that result in delayed product revenue or loss of sales opportunities altogether as potential end-customers turn to competitors' products that are readily available. If we are unable to effectively manage our supply and inventory, our operating results could be adversely affected.

***Because some of the key components in our products come from limited sources of supply, we are susceptible to supply shortages or supply changes, which could disrupt or delay our scheduled product deliveries to our end-customers and may result in the loss of sales and end-customers.***

Our products rely on key components, including integrated circuit components, which our manufacturing partners purchase on our behalf from a limited number of component suppliers, including sole source providers. The manufacturing operations of some of our component suppliers are geographically concentrated in Asia and elsewhere, which makes our supply chain vulnerable to regional disruptions, such as natural disasters, fire, political instability, civil unrest, a power outage, or a localized health risk, and as a result could impair the volume of components that we are able to obtain.

Further, we do not have volume purchase contracts with any of our component suppliers, and they could cease selling to us at any time. If we are unable to obtain a sufficient quantity of these components in a timely manner for any reason, sales of our products could be delayed or halted or we could be forced to expedite ship-

ment of such components or our products at dramatically increased costs. Our component suppliers also change their selling prices frequently in response to market trends, including industry-wide increases in demand, and because we do not have volume purchase contracts with these component suppliers, we are susceptible to price fluctuations related to raw materials and components and may not be able to adjust our prices accordingly. Additionally, poor quality in any of the sole-sourced components in our products could result in lost sales or sales opportunities.

If we are unable to obtain a sufficient volume of the necessary components for our products on commercially reasonable terms or the quality of the components do not meet our requirements, we could also be forced to redesign our products and qualify new components from alternate component suppliers. The resulting stoppage or delay in selling our products and the expense of redesigning our products could result in lost sales opportunities and damage to customer relationships, which would adversely affect our business and operating results.

***The sales prices of our products and subscriptions may decrease, which may reduce our gross profits and adversely impact our financial results.***

The sales prices for our products and subscriptions may decline for a variety of reasons, including competitive pricing pressures, discounts, a change in our mix of products and subscriptions, anticipation of the introduction of new products or subscriptions, or promotional programs. Competition continues to increase in the market segments in which we participate, and we expect competition to further increase in the future, thereby leading to increased pricing pressures. Larger competitors with more diverse product and service offerings may reduce the price of products or subscriptions that compete with ours or may bundle them with other products and subscriptions. Additionally, although we price our products and subscriptions worldwide in U.S. dollars, currency fluctuations in certain countries and regions may negatively impact actual prices that channel partners and end-customers are willing to pay in those countries and regions. Furthermore, we anticipate that the sales prices and gross profits for our products will decrease over product life cycles. We cannot guarantee that we will be successful in developing and introducing new offerings with enhanced functionality on a timely basis, or that our product and subscription offerings, if introduced, will enable us to maintain our prices and gross profits at levels that will allow us to achieve and maintain profitability.

***We generate a significant amount of revenue from sales to distributors, resellers, and end-customers outside of the United States, and we are therefore subject to a number of risks associated with international sales and operations.***

We have a limited history of marketing, selling, and supporting our products and subscriptions internationally. We may experience difficulties in recruiting, training, managing, and retaining an international staff, and specifically staff related to sales management and sales personnel. We also may not be able to maintain successful strategic distributor relationships internationally or recruit additional companies to enter into strategic distributor relationships. Business practices in the international markets that we serve may differ from those in the United States and may require us in the future to include terms other than our standard terms related to payment, warranties, or performance obligations in end-customer contracts.

Additionally, our international sales and operations are subject to a number of risks, including the following:

- political, economic and social uncertainty around the world, macroeconomic challenges in Europe, terrorist activities, and continued hostilities in the Middle East;
- greater difficulty in enforcing contracts and accounts receivable collection and longer collection periods;
- the uncertainty of protection for intellectual property rights in some countries;
- greater risk of unexpected changes in foreign and domestic regulatory practices, tariffs, and tax laws and treaties, including regulatory and trade policy changes adopted by the new administration;
- risks associated with trade restrictions and foreign legal requirements, including the importation, certification, and localization of our products required in foreign countries;

- greater risk of a failure of foreign employees, channel partners, distributors, and resellers to comply with both U.S. and foreign laws, including antitrust regulations, the U.S. Foreign Corrupt Practices Act, the U.K. Bribery Act, U.S. or foreign sanctions regimes and export or import control laws, and any trade regulations ensuring fair trade practices;
- heightened risk of unfair or corrupt business practices in certain geographies and of improper or fraudulent sales arrangements;
- increased expenses incurred in establishing and maintaining office space and equipment for our international operations;
- management communication and integration problems resulting from cultural and geographic dispersion; and
- fluctuations in exchange rates between the U.S. dollar and foreign currencies in markets where we do business and related impact on sales cycles.

These and other factors could harm our ability to gain future international revenues and, consequently, materially impact our business, operating results, and financial condition. The expansion of our existing international operations and entry into additional international markets will require significant management attention and financial resources. Our failure to successfully manage our international operations and the associated risks effectively could limit the future growth of our business.

Further, we are subject to risks associated with changes in economic and political conditions in countries in which we operate or sell our products and subscriptions. For instance, on June 23, 2016, the U.K. held a referendum in which voters approved an exit from the E.U., commonly referred to as “Brexit.” As a result of the referendum, it is expected that the British government will begin negotiating the terms of the U.K.’s withdrawal from the E.U. A withdrawal could, among other outcomes, disrupt the free movement of goods, services and people between the U.K. and the E.U., undermine bilateral cooperation in key policy areas and significantly disrupt trade between the U.K. and the E.U.; however, the full effects of Brexit are uncertain and will depend on any agreements the U.K. makes to retain access to E.U. markets either during a transitional period or more permanently. In addition, Brexit could lead to legal uncertainty and potentially divergent national laws and regulations as the U.K. determines which E.U. laws to replace or replicate. Given these possibilities and others we may not anticipate, as well as the lack of comparable precedent, the full extent to which our business, operating results and financial condition could be adversely affected by Brexit is uncertain.

The announcement of Brexit and the withdrawal of the U.K. from the E.U. may also create global economic uncertainty, which may cause our end-customers to closely monitor their costs and reduce their spending budgets. Any of these effects of Brexit, among others noted above, could adversely affect our business, financial condition, operating results and cash flows.

***We are exposed to fluctuations in currency exchange rates, which could negatively affect our financial condition and operating results.***

Our sales contracts are primarily denominated in U.S. dollars, and therefore, substantially all of our revenue is not subject to foreign currency risk. However, including as a result of concerns regarding the impact of Brexit, there has been, and may continue to be, significant volatility in global stock markets and foreign currency exchange rates that result in the strengthening of the U.S. dollar against foreign currencies in which we conduct business. The strengthening of the U.S. dollar increases the real cost of our platform to our end-customers outside of the United States and may lead to delays in the purchase of our products, subscriptions, and support, and the lengthening of our sales cycle. If the U.S. dollar continues to strengthen, this could adversely affect our financial condition and operating results. In addition, increased international sales in the future, including through our channel partners and other partnerships, may result in greater foreign currency denominated sales, increasing our foreign currency risk.

Our operating expenses incurred outside the United States and denominated in foreign currencies are increasing and are subject to fluctuations due to changes in foreign currency exchange rates. If we are not able to suc-

cessfully hedge against the risks associated with foreign currency fluctuations, our financial condition and operating results could be adversely affected. We have entered into forward contracts in an effort to reduce our foreign currency exchange exposure related to our foreign currency denominated expenditures. Refer to Note 4. Derivative Instruments in Part II, Item 8 of this Annual Report on Form 10-K for more information on our hedging transactions. The effectiveness of our existing hedging transactions and the availability and effectiveness of any hedging transactions we may decide to enter into in the future may be limited and we may not be able to successfully hedge our exposure, which could adversely affect our financial condition and operating results.

***A small number of channel partners represent a large percentage of our revenue and gross accounts receivable. We are exposed to the credit and liquidity risk of some of our channel partners and to credit exposure in weakened markets, which could result in material losses.***

For fiscal 2017, three distributors represented 65.7% of our total revenue, and as of July 31, 2017, four distributors represented 75.9% of our gross accounts receivable. Most of our sales to our channel partners are made on an open credit basis. Although we have programs in place that are designed to monitor and mitigate these risks, we cannot guarantee these programs will be effective in reducing our credit risks, especially as we expand our business internationally. If we are unable to adequately control these risks, our business, operating results, and financial condition could be harmed.

***A portion of our revenue is generated by sales to government entities, which are subject to a number of challenges and risks.***

Sales to government entities are subject to a number of risks. Selling to government entities can be highly competitive, expensive, and time-consuming, often requiring significant upfront time and expense without any assurance that these efforts will generate a sale. The substantial majority of our sales to date to government entities have been made indirectly through our channel partners. Government certification requirements for products and subscriptions like ours may change, thereby restricting our ability to sell into the federal government sector until we have attained the revised certification. If our products and subscriptions are late in achieving or fail to achieve compliance with these certifications and standards, or our competitors achieve compliance with these certifications and standards, we may be disqualified from selling our products and subscriptions to such governmental entity, or be at a competitive disadvantage, which would harm our business, operating results, and financial condition. Government demand and payment for our products and subscriptions may be impacted by public sector budgetary cycles, contracting requirements, and funding authorizations, with funding reductions or delays adversely affecting public sector demand for our products and subscriptions. Government entities may have statutory, contractual, or other legal rights to terminate contracts with our distributors and resellers for convenience or due to a default, and any such termination may adversely impact our future operating results. Governments routinely investigate and audit government contractors' administrative processes, and any unfavorable audit could result in the government refusing to continue buying our products and subscriptions, a reduction of revenue, or fines or civil or criminal liability if the audit uncovers improper or illegal activities, which could adversely impact our operating results in a material way. Finally, for purchases by the U.S. government, the U.S. government may require certain products to be manufactured in the United States and other relatively high cost manufacturing locations, and we may not manufacture all products in locations that meet such requirements, affecting our ability to sell these products and subscriptions to the U.S. government.

***Our ability to sell our products and subscriptions is dependent on the quality of our technical support services and those of our channel partners, and the failure to offer high-quality technical support services could have a material adverse effect on our end-customers' satisfaction with our products and subscriptions, our sales, and our operating results.***

After our products and subscriptions are deployed within our end-customers' networks, our end-customers depend on our technical support services, as well as the support of our channel partners, to resolve any issues relating to our products. Our channel partners often provide similar technical support for third parties' products, and may therefore have fewer resources to dedicate to the support of our products and subscriptions. If we or our channel partners do not effectively assist our end-customers in deploying our products and subscriptions, succeed

in helping our end-customers quickly resolve post-deployment issues, or provide effective ongoing support, our ability to sell additional products and subscriptions to existing end-customers would be adversely affected and our reputation with potential end-customers could be damaged. Many larger enterprise, service provider, and government entity end-customers have more complex networks and require higher levels of support than smaller end-customers. If we or our channel partners fail to meet the requirements of these larger end-customers, it may be more difficult to execute on our strategy to increase our coverage with larger end-customers. Additionally, if our channel partners do not effectively provide support to the satisfaction of our end-customers, we may be required to provide direct support to such end-customers, which would require us to hire additional personnel and to invest in additional resources. It can take several months to recruit, hire, and train qualified technical support employees. We may not be able to hire such resources fast enough to keep up with unexpected demand, particularly if the sales of our products exceed our internal forecasts. As a result, our ability, and the ability of our channel partners to provide adequate and timely support to our end-customers will be negatively impacted, and our end-customers' satisfaction with our products and subscriptions will be adversely affected. Additionally, to the extent that we may need to rely on our sales engineers to provide post-sales support while we are ramping our support resources, our sales productivity will be negatively impacted, which would harm our revenues. Our or our channel partners' failure to provide and maintain high-quality support services could have a material adverse effect on our business, financial condition, and operating results.

***We may acquire other businesses, which could require significant management attention, disrupt our business, dilute stockholder value, and adversely affect our operating results.***

As part of our business strategy, we may acquire or make investments in complementary companies, products, or technologies. For example, in April 2014, we acquired Cyvera Ltd. ("Cyvera"), in May 2015, we acquired CirroSecure, Inc. ("CirroSecure"), and in February 2017 we acquired LightCyber. Our ability as an organization to acquire and integrate other companies, products, or technologies in a successful and timely manner is still relatively unproven. The identification of suitable acquisition candidates is difficult, and we may not be able to complete such acquisitions on favorable terms, if at all. If we do complete future acquisitions, we may not ultimately strengthen our competitive position or achieve our goals and business strategy, we may be subject to claims or liabilities assumed from an acquired company, product, or technology, and any acquisitions we complete could be viewed negatively by our end-customers, investors, and securities analysts. In addition, if we are unsuccessful at integrating past or future acquisitions, or the technologies associated with such acquisitions, into our company, the revenue and operating results of the combined company could be adversely affected. Any integration process may require significant time and resources, which may disrupt our ongoing business and divert management's attention, and we may not be able to manage the integration process successfully. We may not successfully evaluate or utilize the acquired technology or personnel, realize anticipated synergies from the acquisition, or accurately forecast the financial impact of an acquisition transaction and integration of such acquisition, including accounting charges and any potential impairment of goodwill and intangible assets recognized in connection with such acquisitions. We may have to pay cash, incur debt, or issue equity or equity-linked securities to pay for any future acquisitions, each of which could adversely affect our financial condition or the market price of our common stock. Furthermore, the sale of equity or issuance of equity-linked debt to finance any future acquisitions could result in dilution to our stockholders. See the risk factors entitled "Our failure to raise additional capital or generate the significant capital necessary to expand our operations and invest in new products and subscriptions could reduce our ability to compete and could harm our business" and "The issuance of additional stock in connection with financings, acquisitions, investments, our stock incentive plans, the conversion of our Notes or exercise of the related warrants, or otherwise will dilute all other stockholders." The occurrence of any of these risks could harm our business, operating results, and financial condition.

***Claims by others that we infringe their proprietary technology or other rights could harm our business.***

Companies in the enterprise security industry own large numbers of patents, copyrights, trademarks, domain names, and trade secrets and frequently enter into litigation based on allegations of infringement, misappropriation, or other violations of intellectual property or other rights. Third parties have asserted and may in the future assert claims of infringement of intellectual property rights against us. For example, in December 2011, Juniper,



one of our competitors, filed a lawsuit against us alleging patent infringement. In September 2013, we filed a lawsuit against Juniper alleging patent infringement. In May 2014, we entered into a Settlement, Release and Cross-License Agreement with Juniper to resolve all pending disputes between Juniper and us, including dismissal of all pending litigation.

Third parties may also assert such claims against our end-customers or channel partners, whom our standard license and other agreements obligate us to indemnify against claims that our products and subscriptions infringe the intellectual property rights of third parties. In addition, to the extent we hire personnel from competitors, we may be subject to allegations that they have been improperly solicited, that they have divulged proprietary or other confidential information, or that their former employers own their inventions or other work product. Furthermore, we may be unaware of the intellectual property rights of others that may cover some or all of our technology or products and subscriptions. As the number of products and competitors in our market increases and overlaps occur, infringement claims may increase. While we intend to increase the size of our patent portfolio, our competitors and others may now and in the future have significantly larger and more mature patent portfolios than we have. In addition, litigation may involve patent holding companies or other adverse patent owners who have no relevant product revenue and against whom our own patents may therefore provide little or no deterrence or protection. In addition, we have not registered our trademarks in all of our geographic markets and failure to secure those registrations could adversely affect our ability to enforce and defend our trademark rights. Any claim of infringement by a third party, even those without merit, could cause us to incur substantial costs defending against the claim, could distract our management from our business, and could require us to cease use of such intellectual property. Furthermore, because of the substantial amount of discovery required in connection with intellectual property litigation, there is a risk that some of our confidential information could be compromised by disclosure during this type of litigation. A successful claimant could secure a judgment or we may agree to a settlement that prevents us from distributing certain products or performing certain services or that requires us to pay substantial damages, royalties, or other fees. Any of these events could seriously harm our business, financial condition, and operating results.

***Our proprietary rights may be difficult to enforce or protect, which could enable others to copy or use aspects of our products or subscriptions without compensating us.***

We rely and expect to continue to rely on a combination of confidentiality and license agreements with our employees, consultants, and third parties with whom we have relationships, as well as trademark, copyright, patent, and trade secret protection laws, to protect our proprietary rights. We have filed various applications for certain aspects of our intellectual property. Valid patents may not issue from our pending applications, and the claims eventually allowed on any patents may not be sufficiently broad to protect our technology or products and subscriptions. We cannot be certain that we were the first to make the inventions claimed in our pending patent applications or that we were the first to file for patent protection, which could prevent our patent applications from issuing as patents or invalidate our patents following issuance. Additionally, the process of obtaining patent protection is expensive and time-consuming, and we may not be able to prosecute all necessary or desirable patent applications at a reasonable cost or in a timely manner. Any issued patents may be challenged, invalidated or circumvented, and any rights granted under these patents may not actually provide adequate defensive protection or competitive advantages to us. Additional uncertainty may result from changes to patent-related laws and court rulings in the United States and other jurisdictions. As a result, we may not be able to obtain adequate patent protection or effectively enforce any issued patents.

Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or subscriptions or obtain and use information that we regard as proprietary. We generally enter into confidentiality or license agreements with our employees, consultants, vendors, and end-customers, and generally limit access to and distribution of our proprietary information. However, we cannot be certain that we have entered into such agreements with all parties who may have or have had access to our confidential information or that the agreements we have entered into will not be breached. We cannot guarantee that any of the measures we have taken will prevent misappropriation of our technology. Because we may be an attractive target for computer hackers, we may have a greater risk of unauthorized access to, and misappropriation of, our proprietary information. In addition, the laws of some foreign countries do not protect our proprietary rights to as great an

extent as the laws of the United States, and many foreign countries do not enforce these laws as diligently as government agencies and private parties in the United States. From time to time, we may need to take legal action to enforce our patents and other intellectual property rights, to protect our trade secrets, to determine the validity and scope of the proprietary rights of others or to defend against claims of infringement or invalidity. Such litigation could result in substantial costs and diversion of resources and could negatively affect our business, operating results, and financial condition. Attempts to enforce our rights against third parties could also provoke these third parties to assert their own intellectual property or other rights against us, or result in a holding that invalidates or narrows the scope of our rights, in whole or in part. If we are unable to protect our proprietary rights (including aspects of our software and products protected other than by patent rights), we may find ourselves at a competitive disadvantage to others who need not incur the additional expense, time, and effort required to create the innovative products that have enabled us to be successful to date. Any of these events would have a material adverse effect on our business, financial condition, and operating results.

***Our use of open source software in our products and subscriptions could negatively affect our ability to sell our products and subscriptions and subject us to possible litigation.***

Our products and subscriptions contain software modules licensed to us by third-party authors under “open source” licenses. Some open source licenses contain requirements that we make available applicable source code for modifications or derivative works we create based upon the type of open source software we use. If we combine our proprietary software with open source software in a certain manner, we could, under certain open source licenses, be required to release the source code of our proprietary software to the public. This would allow our competitors to create similar products or subscriptions with lower development effort and time and ultimately could result in a loss of product sales for us.

Although we monitor our use of open source software to avoid subjecting our products and subscriptions to conditions we do not intend, the terms of many open source licenses have not been interpreted by United States courts, and there is a risk that these licenses could be construed in a way that could impose unanticipated conditions or restrictions on our ability to commercialize our products and subscriptions. From time to time, there have been claims against companies that distribute or use open source software in their products and subscriptions, asserting that open source software infringes the claimants’ intellectual property rights. We could be subject to suits by parties claiming infringement of intellectual property rights in what we believe to be licensed open source software. If we are held to have breached the terms of an open source software license, we could be required to seek licenses from third parties to continue offering our products and subscriptions on terms that are not economically feasible, to re-engineer our products and subscriptions, to discontinue the sale of our products and subscriptions if re-engineering could not be accomplished on a timely basis, or to make generally available, in source code form, our proprietary code, any of which could adversely affect our business, operating results, and financial condition.

In addition to risks related to license requirements, usage of open source software can lead to greater risks than use of third-party commercial software, as open source licensors generally do not provide warranties or assurance of title or controls on origin of the software. In addition, many of the risks associated with usage of open source software, such as the lack of warranties or assurances of title, cannot be eliminated, and could, if not properly addressed, negatively affect our business. We have established processes to help alleviate these risks, including a review process for screening requests from our development organizations for the use of open source software, but we cannot be sure that our processes for controlling our use of open source software in our products and subscriptions will be effective.

***We license technology from third parties, and our inability to maintain those licenses could harm our business.***

We incorporate technology that we license from third parties, including software, into our products and subscriptions. We cannot be certain that our licensors are not infringing the intellectual property rights of third parties or that our licensors have sufficient rights to the licensed intellectual property in all jurisdictions in which we may sell our products and subscriptions. In addition, some licenses may be non-exclusive, and therefore our competitors may have access to the same technology licensed to us. Some of our agreements with our licensors

may be terminated for convenience by them. If we are unable to continue to license any of this technology because of intellectual property infringement claims brought by third parties against our licensors or against us, or if we are unable to continue our license agreements or enter into new licenses on commercially reasonable terms, our ability to develop and sell products and subscriptions containing such technology would be severely limited, and our business could be harmed. Additionally, if we are unable to license necessary technology from third parties, we may be forced to acquire or develop alternative technology, which we may be unable to do in a commercially feasible manner or at all, and we may be required to use alternative technology of lower quality or performance standards. This would limit and delay our ability to offer new or competitive products and subscriptions and increase our costs of production. As a result, our margins, market share, and operating results could be significantly harmed.

***We face risks associated with having operations and employees located in Israel.***

As a result of our acquisitions of Cyvera and LightCyber, we have offices and employees located in Israel. As a result, political, economic, and military conditions in Israel directly affect our operations. The future of peace efforts between Israel and its Arab neighbors remains uncertain. There has been a significant increase in hostilities and political unrest between Hamas and Israel in the past few years. The effects of these hostilities and violence on the Israeli economy and our operations in Israel are unclear, and we cannot predict the effect on us of further increases in these hostilities or future armed conflict, political instability or violence in the region. Current or future tensions and conflicts in the Middle East could adversely affect our business, operating results, financial condition and cash flows.

In addition, many of our employees in Israel are obligated to perform annual reserve duty in the Israeli military and are subject to being called for active duty under emergency circumstances. We cannot predict the full impact of these conditions on us in the future, particularly if emergency circumstances or an escalation in the political situation occurs. If many of our employees in Israel are called for active duty for a significant period of time, our operations and our business could be disrupted and may not be able to function at full capacity. Any disruption in our operations in Israel could adversely affect our business.

***Our failure to adequately protect personal information could have a material adverse effect on our business.***

A wide variety of provincial, state, national, and international laws and regulations apply to the collection, use, retention, protection, disclosure, transfer, and other processing of personal data. These data protection and privacy-related laws and regulations are evolving and being tested in courts and may result in ever-increasing regulatory and public scrutiny as well as escalating levels of enforcement and sanctions. Further, the interpretation and application of foreign laws and regulations in many cases is uncertain, and our legal and regulatory obligations in foreign jurisdictions are subject to frequent and unexpected changes, including the potential for various regulatory or other governmental bodies to enact new or additional laws or regulations, to issue rulings that invalidate prior laws or regulations, or to increase penalties significantly. For example, the recently adopted E.U. General Data Protection Regulation, effective in May 2018, imposes more stringent data protection requirements, and provides for greater penalties for noncompliance. Our failure to comply with applicable laws and regulations, or to protect personal data, could result in enforcement action against us, including fines, imprisonment of company officials and public censure, claims for damages by end-customers and other affected individuals, damage to our reputation and loss of goodwill (both in relation to existing end-customers and prospective end-customers), any of which could have a material adverse effect on our operations, financial performance, and business. Evolving and changing definitions of personal data and personal information, within the E.U., the United States, and elsewhere, especially relating to classification of IP addresses, machine identification, location data, and other information, may limit or inhibit our ability to operate or expand our business, including limiting strategic partnerships that may involve the sharing of data. Even the perception of privacy concerns, whether or not valid, may harm our reputation and inhibit adoption of our products and subscriptions by current and future end-customers.

***We are subject to governmental export and import controls that could subject us to liability or impair our ability to compete in international markets.***

Because we incorporate encryption technology into our products, certain of our products are subject to U.S. export controls and may be exported outside the United States only with the required export license or through an export license exception. If we were to fail to comply with U.S. export licensing requirements, U.S. customs regulations, U.S. economic sanctions, or other laws, we could be subject to substantial civil and criminal penalties, including fines, incarceration for responsible employees and managers, and the possible loss of export or import privileges. Obtaining the necessary export license for a particular sale may be time-consuming and may result in the delay or loss of sales opportunities. Furthermore, U.S. export control laws and economic sanctions prohibit the shipment of certain products to U.S. embargoed or sanctioned countries, governments, and persons. Even though we take precautions to ensure that our channel partners comply with all relevant regulations, any failure by our channel partners to comply with such regulations could have negative consequences for us, including reputational harm, government investigations, and penalties.

In addition, various countries regulate the import of certain encryption technology, including through import permit and license requirements, and have enacted laws that could limit our ability to distribute our products or could limit our end-customers' ability to implement our products in those countries. Changes in our products or changes in export and import regulations may create delays in the introduction of our products into international markets, prevent our end-customers with international operations from deploying our products globally or, in some cases, prevent or delay the export or import of our products to certain countries, governments, or persons altogether. Any change in export or import regulations, economic sanctions or related legislation, shift in the enforcement or scope of existing regulations, or change in the countries, governments, persons, or technologies targeted by such regulations, could result in decreased use of our products by, or in our decreased ability to export or sell our products to, existing or potential end-customers with international operations. Any decreased use of our products or limitation on our ability to export to or sell our products in international markets would likely adversely affect our business, financial condition, and operating results.

***Our failure to raise additional capital or generate the significant capital necessary to expand our operations and invest in new products and subscriptions could reduce our ability to compete and could harm our business.***

We intend to continue to make investments to support our business growth and may require additional funds to respond to business challenges, including the need to develop new features to enhance our platform, improve our operating infrastructure, or acquire complementary businesses and technologies. Accordingly, we may need to engage in equity or debt financings to secure additional funds. If we raise additional equity or equity-linked financing, our stockholders may experience significant dilution of their ownership interests and the market price of our common stock could decline. For example, in June 2014, we issued 0.0% Convertible Senior Notes due 2019 (the "Notes") and any conversion of some or all of the Notes into common stock will dilute the ownership interests of existing stockholders to the extent we deliver shares upon conversion of any of the Notes. See the risk factor entitled "The issuance of additional stock in connection with financings, acquisitions, investments, our stock incentive plans, the conversion of our Notes, or otherwise will dilute all other stockholders." Furthermore, if we engage in additional debt financing, the holders of our debt would have priority over the holders of our common stock, and we may be required to accept terms that restrict our ability to incur additional indebtedness. We may also be required to take other actions that would otherwise be in the interests of the debt holders and would require us to maintain specified liquidity or other ratios, any of which could harm our business, operating results, and financial condition. We may not be able to obtain additional financing on terms favorable to us, if at all. If we are unable to obtain adequate financing or financing on terms satisfactory to us when we require it, our ability to continue to support our business growth and to respond to business challenges could be significantly impaired, and our business may be adversely affected.

***We have a corporate structure aligned with the international nature of our business activities, and if we do not achieve increased tax benefits as a result of our corporate structure, our financial condition and operating results could be adversely affected.***

We have reorganized our corporate structure and intercompany relationships to more closely align with the international nature of our business activities. This corporate structure may allow us to reduce our overall effec-

tive tax rate through changes in how we use our intellectual property, international procurement, and sales operations. This corporate structure may also allow us to obtain financial and operational efficiencies. These efforts require us to incur expenses in the near term for which we may not realize related benefits. If the structure is not accepted by the applicable tax authorities, if there are any changes in domestic and international tax laws that negatively impact the structure, including proposed and potential new legislation to reform U.S. taxation of international business activities, and recent guidance regarding base erosion and profit shifting (“BEPS”) provided by the Organisation for Economic Co-operation and Development, or if we do not operate our business consistent with the structure and applicable tax provisions, we may fail to achieve the reduction in our overall effective tax rate and the other financial and operational efficiencies that we anticipate as a result of the structure and our future financial condition and operating results may be negatively impacted.

***We may have exposure to greater than anticipated tax liabilities.***

Our income tax obligations are based in part on our corporate structure and intercompany arrangements, including the manner in which we develop, value, and use our intellectual property and the valuations of our intercompany transactions. The tax laws applicable to our business, including the laws of the United States and other jurisdictions, are subject to interpretation and certain jurisdictions may aggressively interpret their laws in an effort to raise additional tax revenue. The tax authorities of the jurisdictions in which we operate may challenge our methodologies for valuing developed technology or intercompany arrangements, which could increase our worldwide effective tax rate and harm our financial position and operating results. It is possible that tax authorities may disagree with certain positions we have taken and any adverse outcome of such a review or audit could have a negative effect on our financial position and operating results. Further, the determination of our worldwide provision for income taxes and other tax liabilities requires significant judgment by management, and there are transactions where the ultimate tax determination is uncertain. Although we believe that our estimates are reasonable, the ultimate tax outcome may differ from the amounts recorded in our consolidated financial statements and may materially affect our financial results in the period or periods for which such determination is made.

***If our estimates or judgments relating to our critical accounting policies are based on assumptions that change or prove to be incorrect, our operating results could fall below our publicly announced guidance or the expectations of securities analysts and investors, resulting in a decline in the market price of our common stock.***

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in our consolidated financial statements and accompanying notes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets, liabilities, equity, revenue, and expenses that are not readily apparent from other sources. For more information, refer to the section entitled “Critical Accounting Estimates” in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in Part II, Item 7 of this Annual Report on Form 10-K. Additionally, as we work toward adopting and implementing the new revenue accounting standard, management will make judgments and assumptions based on our interpretation of the new standard. The new revenue standard is principle based and interpretation of those principles may vary from company to company based on their unique circumstances. It is possible that interpretation, industry practice, and guidance may evolve as we work toward implementing the new standard. If our assumptions change or if actual circumstances differ from our assumptions, our operating results may be adversely affected and could fall below our publicly announced guidance or the expectations of securities analysts and investors, resulting in a decline in the market price of our common stock.

***Failure to comply with governmental laws and regulations could harm our business.***

Our business is subject to regulation by various federal, state, local, and foreign governmental agencies, including agencies responsible for monitoring and enforcing employment and labor laws, workplace safety, product safety, environmental laws, consumer protection laws, anti-bribery laws, import/export controls, federal securities laws, and tax laws and regulations. In certain jurisdictions, these regulatory requirements may be more

stringent than those in the United States. Noncompliance with applicable regulations or requirements could subject us to investigations, sanctions, mandatory product recalls, enforcement actions, disgorgement of profits, fines, damages, civil and criminal penalties, or injunctions. If any governmental sanctions are imposed, or if we do not prevail in any possible civil or criminal litigation resulting from any alleged noncompliance, our business, operating results, and financial condition could be materially adversely affected. In addition, responding to any action will likely result in a significant diversion of management's attention and resources and an increase in professional fees. Enforcement actions, litigation, and sanctions could harm our business, operating results, and financial condition.

***If we fail to comply with environmental requirements, our business, financial condition, operating results, and reputation could be adversely affected.***

We are subject to various environmental laws and regulations including laws governing the hazardous material content of our products and laws relating to the collection of and recycling of electrical and electronic equipment. Examples of these laws and regulations include the E.U. Restriction on the Use of Certain Hazardous Substances in Electrical and Electronic Equipment Directive ("RoHS") and the E.U. Waste Electrical and Electronic Equipment Directive ("WEEE Directive"), as well as the implementing legislation of the E.U. member states. Similar laws and regulations have been passed or are pending in China, South Korea, Norway, and Japan and may be enacted in other regions, including in the United States, and we are, or may in the future be, subject to these laws and regulations.

The E.U. RoHS and the similar laws of other jurisdictions limit the content of certain hazardous materials such as lead, mercury, and cadmium in the manufacture of electrical equipment, including our products. Our current products comply with the E.U. RoHS requirements. However, if there are changes to this or other laws (or their interpretation) or if new similar laws are passed in other jurisdictions, we may be required to reengineer our products to use components compatible with these regulations. This reengineering and component substitution could result in additional costs to us or disrupt our operations or logistics.

The WEEE Directive requires electronic goods producers to be responsible for the collection, recycling, and treatment of such products. Changes in interpretation of the directive may cause us to incur costs or have additional regulatory requirements to meet in the future in order to comply with this directive, or with any similar laws adopted in other jurisdictions.

We are also subject to environmental laws and regulations governing the management of hazardous materials, which we use in small quantities in our engineering labs. Our failure to comply with past, present, and future similar laws could result in reduced sales of our products, substantial product inventory write-offs, reputational damage, penalties, and other sanctions, any of which could harm our business and financial condition. We also expect that our products will be affected by new environmental laws and regulations on an ongoing basis. To date, our expenditures for environmental compliance have not had a material impact on our operating results or cash flows, and although we cannot predict the future impact of such laws or regulations, they will likely result in additional costs and may increase penalties associated with violations or require us to change the content of our products or how they are manufactured, which could have a material adverse effect on our business, operating results, and financial condition.

***Our business is subject to the risks of earthquakes, fire, power outages, floods, and other catastrophic events, and to interruption by man-made problems such as terrorism.***

Both our corporate headquarters and the location where our products are manufactured are located in the San Francisco Bay Area, a region known for seismic activity. In addition, other natural disasters, such as fire or floods, a significant power outage, terrorism, or other geo-political unrest could affect our supply chain, manufacturers, logistics providers, channel partners, or end-customers or the economy as a whole and such disruption could impact our shipments and sales. These risks may be further increased if the disaster recovery plans for us and our suppliers prove to be inadequate. To the extent that any of the above should result in delays or cancellations of customer orders, the loss of customers, or the delay in the manufacture, deployment, or shipment of our products, our business, financial condition, and operating results would be adversely affected.

## **Risks Related to Our Notes**

***We may not have the ability to raise the funds necessary to settle conversions of the Notes or to repurchase the Notes upon a fundamental change, and our future debt may contain limitations on our ability to pay cash upon conversion or repurchase of the Notes.***

Holders of the Notes will have the right to require us to repurchase all or a portion of their Notes upon the occurrence of a fundamental change at a repurchase price equal to 100% of the principal amount of the Notes to be repurchased, plus accrued and unpaid special interest, if any, to, but excluding, the fundamental change repurchase date. In addition, upon conversion of the Notes, we will be required to make cash payments for each \$1,000 in principal amount of Notes converted of at least the lesser of \$1,000 and the sum of the daily conversion values. However, we may not have enough available cash or be able to obtain financing at the time we are required to make repurchases of Notes surrendered therefor or pay cash with respect to Notes being converted.

In addition, our ability to repurchase or to pay cash upon conversion of the Notes may be limited by law, regulatory authority or agreements governing our future indebtedness. Our failure to repurchase the Notes at a time when the repurchase is required by the indenture governing the Notes or to pay cash upon conversion of the Notes as required by the indenture would constitute a default under the indenture. A default under the indenture or the fundamental change itself could also lead to a default under agreements governing our future indebtedness. If the payment of the related indebtedness were to be accelerated after any applicable notice or grace periods, we may not have sufficient funds to repay the indebtedness and repurchase the Notes or to pay cash upon conversion of the Notes.

***We may still incur substantially more debt or take other actions that would diminish our ability to make payments on the Notes when due.***

We and our subsidiaries may be able to incur substantial additional debt in the future, subject to the restrictions contained in our debt instruments, some of which may be secured debt. We are not restricted under the terms of the indenture governing the Notes from incurring additional debt, securing existing or future debt, recapitalizing our debt or taking a number of other actions that are not limited by the terms of the indenture governing the Notes that could have the effect of diminishing our ability to make payments on the Notes when due. While the terms of any future indebtedness we may incur could restrict our ability to incur additional indebtedness, any such restrictions will indirectly benefit holders of the Notes only to the extent any such indebtedness or credit facility is not repaid or does not mature while the Notes are outstanding.

## **Risks Related to Ownership of Our Common Stock**

***Our actual operating results may differ significantly from our guidance.***

From time to time, we have released, and may continue to release, guidance in our quarterly earnings releases, quarterly earnings conference calls, or otherwise, regarding our future performance that represents our management's estimates as of the date of release. This guidance, which includes forward-looking statements, has been and will be based on projections prepared by our management. These projections are not prepared with a view toward compliance with published guidelines of the American Institute of Certified Public Accountants, and neither our registered public accountants nor any other independent expert or outside party compiles or examines the projections. Accordingly, no such person expresses any opinion or any other form of assurance with respect to the projections.

Projections are based upon a number of assumptions and estimates that, while presented with numerical specificity, are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control and are based upon specific assumptions with respect to future business decisions, some of which will change. The rapidly evolving market in which we operate may make it difficult to evaluate our current business and our future prospects, including our ability to plan for and model future growth. We intend to state possible outcomes as high and low ranges which are intended to provide a sensitivity analysis as variables are changed. However, actual results will vary from our guidance and the varia-

tions may be material. The principal reason that we release guidance is to provide a basis for our management to discuss our business outlook as of the date of release with analysts and investors. We do not accept any responsibility for any projections or reports published by any such persons. Investors are urged not to rely upon our guidance in making an investment decision regarding our common stock.

Any failure to successfully implement our operating strategy or the occurrence of any of the events or circumstances set forth in this “Risk Factors” section in this Annual Report on Form 10-K could result in our actual operating results being different from our guidance, and the differences may be adverse and material.

***The market price of our common stock historically has been volatile and the value of your investment could decline.***

The market price of our common stock has been volatile since our initial public offering (“IPO”). Since shares of our common stock were sold in our IPO in July 2012 at a price of \$42.00 per share, the reported high and low sales prices of our common stock has ranged from \$200.55 to \$39.08, through August 24, 2017. The market price of our common stock may fluctuate widely in response to various factors, some of which are beyond our control. These factors include:

- announcements of new products, subscriptions or technologies, commercial relationships, strategic partnerships, acquisitions or other events by us or our competitors;
- price and volume fluctuations in the overall stock market from time to time;
- news announcements that affect investor perception of our industry, including reports related to the discovery of significant cyberattacks;
- significant volatility in the market price and trading volume of technology companies in general and of companies in our industry;
- fluctuations in the trading volume of our shares or the size of our public float;
- actual or anticipated changes in our operating results or fluctuations in our operating results;
- whether our operating results meet the expectations of securities analysts or investors;
- actual or anticipated changes in the expectations of securities analysts or investors, whether as a result of our forward- looking statements, our failure to meet such expectation or otherwise;
- inaccurate or unfavorable research reports about our business and industry published by securities analysts or reduced coverage of our company by securities analysts;
- litigation involving us, our industry, or both;
- regulatory developments in the United States, foreign countries or both;
- major catastrophic events;
- sales of large blocks of our common stock or substantial future sales by our directors, executive officers, employees and significant stockholders;
- sales of our common stock by investors who view the Notes as a more attractive means of equity participation in us;
- hedging or arbitrage trading activity involving our common stock as a result of the existence of the Notes;
- departures of key personnel; or
- economic uncertainty around the world, in particular, macroeconomic challenges in Europe.

The market price of our common stock could decline for reasons unrelated to our business, operating results, or financial condition and as a result of events that do not directly affect us. In the past, following periods of volatility in the market price of a company’s securities, securities class action litigation has often been brought



against that company. Securities litigation could result in substantial costs and divert our management's attention and resources from our business. This could have a material adverse effect on our business, operating results, and financial condition.

***The issuance of additional stock in connection with financings, acquisitions, investments, our stock incentive plans, the conversion of our Notes or exercise of the related warrants, or otherwise will dilute all other stockholders.***

Our amended and restated certificate of incorporation authorizes us to issue up to 1.0 billion shares of common stock and up to 100.0 million shares of preferred stock with such rights and preferences as may be determined by our board of directors. Subject to compliance with applicable rules and regulations, we may issue shares of common stock or securities convertible into shares of our common stock from time to time in connection with a financing, acquisition, investment, our stock incentive plans, the conversion of our Notes, the settlement of our warrants, or otherwise. Any such issuance could result in substantial dilution to our existing stockholders and cause the market price of our common stock to decline.

***We cannot guarantee that our recently announced share repurchase program will be fully consummated or that it will enhance shareholder value, and share repurchases could affect the price of our common stock.***

On February 24, 2017, our board of directors authorized a \$500.0 million increase to our existing share repurchase program, bringing the total authorization to \$1.0 billion, funded from available working capital. This authorization is an increase to the existing \$500.0 million repurchase authorization previously approved by our board of directors in August 2016. Additionally, our board of directors extended the term of the repurchase authorization, which will now expire on December 31, 2018. Although our board of directors has authorized a share repurchase program, the share repurchase program does not obligate us to repurchase any specific dollar amount or to acquire any specific number of shares. The share repurchase program could affect the price of our common stock, increase volatility and diminish our cash reserves. In addition, it may be suspended or terminated at any time, which may result in a decrease in the price of our common stock.

***We are subject to risks associated with our strategic investments. Other-than-temporary impairments in the value of our investments could negatively impact our financial results.***

In June 2017, we announced our plans to form the \$20.0 million Palo Alto Networks Venture Fund. The fund is aimed at seed-, early-, and growth-stage security companies with a cloud-based application approach. We may not realize a return on our capital investments. Many such private companies generate net losses and the market for their products, services or technologies may be slow to develop, and, therefore, are dependent on the availability of later rounds of financing from banks or investors on favorable terms to continue their operations. The financial success of our investment in any company is typically dependent on a liquidity event, such as a public offering, acquisition or other favorable market event reflecting appreciation to the cost of our initial investment. The capital markets for public offerings and acquisitions are dynamic and the likelihood of liquidity events for the companies we have and intend to invest in could significantly change. Further, valuations of privately-held companies are inherently complex due to the lack of readily available market data and as such, the basis for these valuations is subject to the timing and accuracy of the data received from these companies. If we determine that any of our investments in such companies have experienced a decline in value, we may be required to record an other-than-temporary impairment, which could be material and negatively impact our financial results. All of our investments are subject to a risk of a partial or total loss of investment capital.

***The convertible note hedge and warrant transactions may affect the value of our common stock.***

In connection with the sale of the Notes, we entered into convertible note hedge transactions with certain counterparties. We also entered into warrant transactions with the counterparties pursuant to which we sold warrants for the purchase of our common stock. The convertible note hedge transactions are expected generally to reduce the potential dilution to our common stock upon any conversion of Notes and/or offset any cash payments we are required to make in excess of the principal amount of any converted Notes. The warrants could separately have a dilutive effect to the extent that the market price per share of our common stock exceeds the strike price of the warrants unless, subject to certain conditions, we elect to cash settle the warrants.

The counterparties or their respective affiliates may modify their hedge positions by entering into or unwinding various derivatives with respect to our common stock and/or purchasing or selling our common stock or other securities of ours in secondary market transactions prior to the maturity of the Notes (and are likely to do so during any observation period related to a conversion of Notes). This activity could also cause or avoid an increase or a decrease in the market price of our common stock or the Notes, which could affect a Note holder's ability to convert the Notes and, to the extent the activity occurs during any observation period related to a conversion of Notes, it could affect the amount and value of the consideration that such Note holder will receive upon conversion of the Notes.

We do not make any representation or prediction as to the direction or magnitude of any potential effect that the transactions described above may have on the price of the Notes or our common stock. In addition, we do not make any representation that the counterparties or their respective affiliates will engage in these transactions or that these transactions, once commenced, will not be discontinued without notice.

***We do not intend to pay dividends for the foreseeable future.***

We have never declared or paid any dividends on our common stock. We intend to retain any earnings to finance the operation and expansion of our business, and we do not anticipate paying any cash dividends in the future. As a result, you may only receive a return on your investment in our common stock if the market price of our common stock increases.

***The requirements of being a public company may strain our resources, divert management's attention, and affect our ability to attract and retain qualified board members.***

As a public company, we are subject to the reporting requirements of the Exchange Act, the Sarbanes-Oxley Act, the Dodd-Frank Act, the listing requirements of the New York Stock Exchange ("NYSE"), and other applicable securities rules and regulations. Compliance with these rules and regulations have increased our legal and financial compliance costs, made some activities more difficult, time-consuming or costly, and increased demand on our systems and resources. Among other things, the Exchange Act requires that we file annual, quarterly, and current reports with respect to our business and operating results. In addition, the Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal control over financial reporting. In order to meet the requirements of this standard, significant resources and management oversight may be required. As a result, management's attention may be diverted from other business concerns, which could harm our business and operating results. Although we have already hired additional employees to comply with these requirements, we may need to hire even more employees in the future, which will increase our costs and expenses.

In addition, changing laws, regulations, and standards related to corporate governance and public disclosure are creating uncertainty for public companies, increasing legal and financial compliance costs, and making some activities more time-consuming. These laws, regulations, and standards are subject to varying interpretations, in many cases due to their lack of specificity, and, as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies. This could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We intend to invest resources to comply with evolving laws, regulations, and standards, and this investment may result in increased general and administrative expense and a diversion of management's time and attention from revenue-generating activities to compliance activities. If our efforts to comply with new laws, regulations, and standards differ from the activities intended by regulatory or governing bodies, regulatory authorities may initiate legal proceedings against us and our business may be harmed.

We also expect that being a public company and these new rules and regulations will make it more expensive for us to obtain and maintain director and officer liability insurance, and in the future, we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. These factors could also make it more difficult for us to attract and retain qualified members of our board of directors, particularly to serve on our Audit Committee and Compensation Committee, and qualified executive officers.

***We are obligated to maintain proper and effective internal control over financial reporting. We may not complete our analysis of our internal control over financial reporting in a timely manner, or this internal control may not be determined to be effective, which may adversely affect investor confidence in our company and, as a result, the value of our common stock.***

While we were able to determine in our management's report for fiscal 2017 that our internal control over financial reporting is effective, as well as provide an unqualified attestation report from our independent registered public accounting firm to that effect, we may not be able to complete our evaluation, testing, and any required remediation in a timely fashion, may be unable to assert that our internal controls are effective, or our independent registered public accounting firm may not be able to formally attest to the effectiveness of our internal control over financial reporting in the future. In the event that our chief executive officer, chief financial officer, or independent registered public accounting firm determines in the future that our internal control over financial reporting is not effective as defined under Section 404, we could be subject to one or more investigations or enforcement actions by state or federal regulatory agencies, stockholder lawsuits or other adverse actions requiring us to incur defense costs, pay fines, settlements or judgments and causing investor perceptions to be adversely affected and potentially resulting in a decline in the market price of our stock.

***Our charter documents and Delaware law, as well as certain provisions of our Notes, could discourage takeover attempts and lead to management entrenchment, which could also reduce the market price of our common stock.***

Provisions in our amended and restated certificate of incorporation and amended and restated bylaws may have the effect of delaying or preventing a change in control of our company or changes in our management. Our amended and restated certificate of incorporation and amended and restated bylaws include provisions that:

- establish that our board of directors is divided into three classes, Class I, Class II and Class III, with three-year staggered terms;
- authorize our board of directors to issue shares of preferred stock and to determine the price and other terms of those shares, including preferences and voting rights, without stockholder approval;
- provide our board of directors with the exclusive right to elect a director to fill a vacancy created by the expansion of our board of directors or the resignation, death or removal of a director;
- prohibit our stockholders from taking action by written consent;
- specify that special meetings of our stockholders may be called only by the chairman of our board of directors, our president, our secretary, or a majority vote of our board of directors;
- require the affirmative vote of holders of at least 66 2/3% of the voting power of all of the then outstanding shares of the voting stock, voting together as a single class, to amend the provisions of our amended and restated certificate of incorporation relating to the issuance of preferred stock and management of our business or our amended and restated bylaws;
- authorize our board of directors to amend our bylaws by majority vote; and
- establish advance notice procedures with which our stockholders must comply to nominate candidates to our board of directors or to propose matters to be acted upon at a stockholders' meeting.

These provisions may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for our stockholders to replace members of our board of directors, which is responsible for appointing the members of management. In addition, as a Delaware corporation, we are subject to Section 203 of the Delaware General Corporation Law. These provisions may prohibit large stockholders, in particular those owning 15% or more of our outstanding voting stock, from merging or combining with us for a certain period of time. Additionally, certain provisions of our Notes could make it more difficult or more expensive for a third party to acquire us. The application of Section 203 or certain provisions of our Notes also could have the effect of delaying or preventing a change in control of us. Any of these provisions could, under certain circumstances, depress the market price of our common stock.

**ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2. PROPERTIES**

Our corporate headquarters is located in Santa Clara, California where we lease approximately 941,000 square feet of space under three lease agreements that expire in July 2028, with options to extend the lease terms through July 2046. We also lease a total of approximately 422,000 square feet of space at two other locations in Santa Clara, which collectively served as our previous corporate headquarters through August 2017, when we relocated to our current campus. The leases for our previous corporate headquarters expire in April 2021 and July 2023. We also lease space for personnel in locations throughout the United States and various international locations, including Israel, the Netherlands, Singapore, Australia, and Japan. In addition, we provide our cloud-based subscription offerings through data centers operated under co-location arrangements in the United States, Europe, and Asia. Refer to Note 9. Commitments and Contingencies of Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report on Form 10-K for more information on our operating leases.

We believe that our current facilities are adequate to meet our current needs. We intend to expand our facilities or add new facilities as we add employees and enter new geographic markets, and we believe that suitable additional or alternative space will be available as needed to accommodate ongoing operations and any such growth. However, we expect to incur additional expenses in connection with such new or expanded facilities.

**ITEM 3. LEGAL PROCEEDINGS**

The information set forth under the “Litigation” subheading in Note 9. Commitments and Contingencies of Notes to Consolidated Financial Statements in Part II, Item 8 of this Annual Report on Form 10-K is incorporated herein by reference.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

## PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

#### Market Information

Our common stock, \$0.0001 par value per share, began trading on the NYSE on July 20, 2012, where its prices are quoted under the symbol "PANW."

#### Holder of Record

As of August 24, 2017, there were 88 holders of record of our common stock. Because many of our shares of common stock are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these record holders.

#### Price Range of Our Common Stock

The following table sets forth the reported high and low sales prices of our common stock for the periods indicated, as regularly quoted on the NYSE:

	<u>High</u>	<u>Low</u>
<b>Year Ended July 31, 2016</b>		
First Quarter	\$ 191.00	\$ 140.39
Second Quarter	\$ 194.73	\$ 135.89
Third Quarter	\$ 165.29	\$ 111.09
Fourth Quarter	\$ 151.99	\$ 114.64
<b>Year Ended July 31, 2017</b>		
First Quarter	\$ 163.01	\$ 124.74
Second Quarter	\$ 165.69	\$ 123.57
Third Quarter	\$ 157.65	\$ 107.31
Fourth Quarter	\$ 143.90	\$ 108.15

#### Dividend Policy

We have never declared or paid, and do not anticipate declaring or paying in the foreseeable future, any cash dividends on our capital stock. Any future determination as to the declaration and payment of dividends, if any, will be at the discretion of our board of directors, subject to applicable laws and will depend on then existing conditions, including our financial condition, operating results, contractual restrictions, capital requirements, business prospects, and other factors our board of directors may deem relevant.

#### Securities Authorized for Issuance under Equity Compensation Plans

See Part III, Item 12 "Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters" of this Annual Report on Form 10-K for more information regarding securities authorized for issuance.

#### Recent Sale of Unregistered Securities

There were no sales of unregistered securities during fiscal 2017.

## Purchases of Equity Securities by the Issuer and Affiliated Purchasers

The following table summarizes stock repurchases during the three months ended July 31, 2017 (in millions, except per share amounts):

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs <sup>(1)</sup>	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs <sup>(1)</sup>
May 1, 2017 to May 31, 2017 <sup>(2)</sup>	—	\$ 116.50	—	\$ 704.9
June 1, 2017 to June 30, 2017 <sup>(3)</sup>	0.5	\$ 133.82	0.5	\$ 636.1
July 1, 2017 to July 31, 2017 <sup>(3)</sup>	0.4	\$ 135.57	0.4	\$ 580.0
Total	0.9	\$ 133.91	0.9	

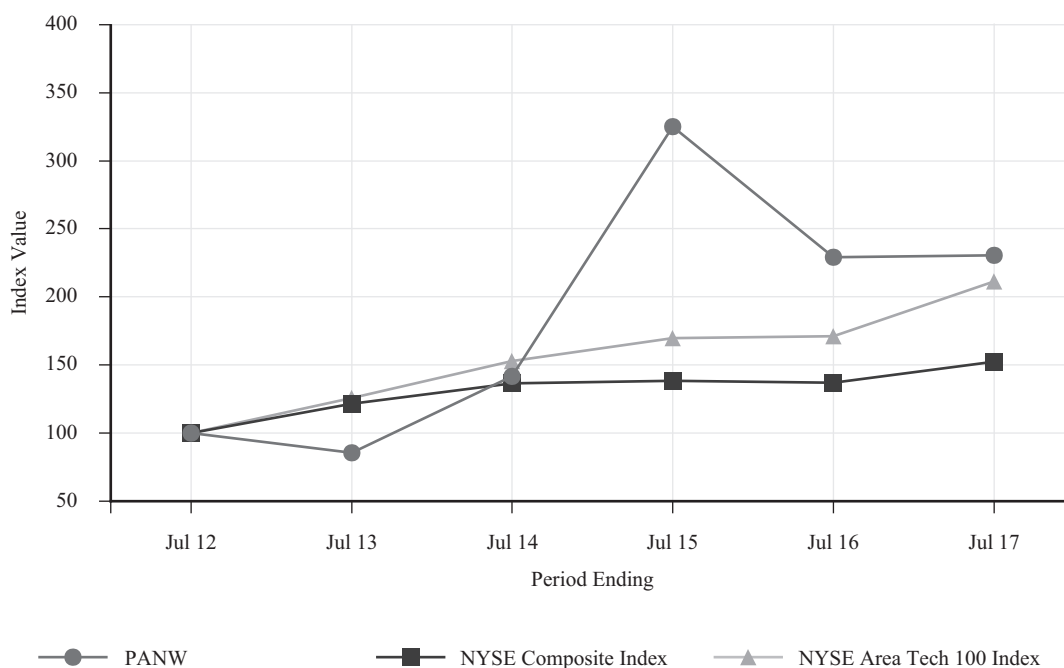
- (1) On August 26, 2016, our board of directors authorized a \$500.0 million share repurchase which is funded from available working capital. On February 24, 2017, our board of directors authorized a \$500.0 million increase to our repurchase program, bringing the total authorization to \$1.0 billion. Repurchases may be made at management's discretion from time to time on the open market, through privately negotiated transactions, transactions structured through investment banking institutions, block purchase techniques, 10b5-1 trading plans, or a combination of the foregoing. The repurchase authorization will expire on December 31, 2018, and may be suspended or discontinued at any time.
- (2) Repurchases during the month ended May 31, 2017 include shares of restricted common stock delivered by certain employees upon vesting of equity awards to satisfy tax withholding requirements. The number of shares delivered by these employees to satisfy tax withholding requirements during the period was not significant.
- (3) Repurchases during the months ended June 30, 2017 and July 31, 2017 consisted of repurchases under our share repurchase program, for which the average price paid per share excludes costs associated with the repurchases.

## Stock Price Performance Graph

*This performance graph shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), or incorporated by reference into any filing of Palo Alto Networks, Inc. under the Securities Act of 1933, as amended, or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.*

This performance graph compares the cumulative total return on our common stock with that of the NYSE Composite Index and the NYSE Arca Tech 100 Index for the five years ended July 31, 2017. This performance graph assumes \$100 was invested on July 31, 2012, in each of the common stock of Palo Alto Networks, Inc., the NYSE Composite Index, and the NYSE Arca Tech 100 Index, and assumes the reinvestment of any dividends. The stock price performance on this performance graph is not necessarily indicative of future stock price performance.

### Palo Alto Networks, Inc. Comparison of Total Return Performance



Company/Index	7/31/2012	7/31/2013	7/31/2014	7/31/2015	7/31/2016	7/31/2017
Palo Alto Networks, Inc.	\$ 100.00	\$ 85.65	\$ 141.51	\$ 325.22	\$ 229.07	\$ 230.63
NYSE Composite Index	\$ 100.00	\$ 121.55	\$ 136.40	\$ 138.38	\$ 137.15	\$ 152.18
NYSE Arca Tech 100 Index	\$ 100.00	\$ 125.69	\$ 152.74	\$ 169.47	\$ 171.17	\$ 211.12

## ITEM 6. SELECTED FINANCIAL DATA

The selected consolidated statement of operations data for fiscal 2017, 2016, and 2015 and the consolidated balance sheet data as of July 31, 2017 and 2016 are derived from our audited consolidated financial statements included elsewhere in this Annual Report on Form 10-K. The selected consolidated statement of operations data for fiscal 2014 and 2013 and the consolidated balance sheet data as of July 31, 2015, 2014, and 2013 are derived from audited financial statements not included in this Annual Report on Form 10-K. Our historical results are not necessarily indicative of the results that may be expected in the future. The selected consolidated financial data below should be read in conjunction with the section entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in Part II, Item 7 of this Annual Report on Form 10-K and our consolidated financial statements and related notes included in Part II, Item 8 of this Annual Report on Form 10-K.

	Year Ended July 31,				
	2017	2016	2015	2014	2013
	(in millions)				
<b>Selected Consolidated Statements of Operations Data:</b>					
Total revenue	\$ 1,761.6	\$ 1,378.5	\$ 928.1	\$ 598.2	\$ 396.1
Total gross profit	1,285.0	1,008.5	676.6	438.6	286.4
Operating loss <sup>(1)</sup>	(179.8)	(157.3)	(99.8)	(196.2)	(9.9)
Net loss <sup>(1)</sup>	\$ (216.6)	\$ (192.7)	\$ (131.3)	\$ (207.4)	\$ (20.5)
Net loss per share, basic and diluted <sup>(1)</sup>	\$ (2.39)	\$ (2.21)	\$ (1.61)	\$ (2.79)	\$ (0.30)
Weighted-average shares used to compute net loss per share, basic and diluted	90.6	87.1	81.6	74.3	68.7
	July 31,				
	2017	2016	2015	2014	2013
	(in millions)				
<b>Selected Consolidated Balance Sheet Data:</b>					
Cash and cash equivalents	\$ 744.3	\$ 734.4	\$ 375.8	\$ 653.8	\$ 310.6
Investments	1,420.0	1,204.0	952.0	320.6	126.3
Working capital <sup>(1)(2)(3)</sup>	775.0	927.2	79.3	630.9	334.5
Total assets <sup>(1)</sup>	3,438.3	2,858.2	2,026.1	1,502.6	603.9
Total deferred revenue	1,773.5	1,240.8	713.7	422.6	249.2
Convertible senior notes, net <sup>(2)(3)</sup>	524.7	500.2	476.8	454.6	—
Common stock and additional paid-in capital	1,599.7	1,515.5	988.7	804.4	381.6
Total stockholders’ equity <sup>(1)</sup>	\$ 759.6	\$ 894.9	\$ 559.7	\$ 506.7	\$ 291.4

- (1) Prior period amounts have been adjusted due to our voluntary change in accounting policy for sales commissions. Refer to Note 1. Description of Business and Summary of Significant Accounting Policies in Part II, Item 8 of this Annual Report on Form 10-K for more information.
- (2) Prior period amounts have been adjusted due to our adoption of new accounting guidance related to the presentation of debt issuance costs. Refer to Note 1. Description of Business and Summary of Significant Accounting Policies in Part II, Item 8 of this Annual Report on Form 10-K for more information.
- (3) The convertible senior notes, net balance was classified as a current liability in our consolidated balance sheets as of July 31, 2015, and classified as a long-term liability for all other periods presented.



## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes appearing elsewhere in this Annual Report on Form 10-K. The following discussion and analysis contains forward-looking statements based on current expectations and assumptions that are subject to risks and uncertainties, which could cause our actual results to differ materially from those anticipated or implied by any forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this Annual Report on Form 10-K, and in particular, the risks discussed under the caption "Risk Factors" in Part I, Item 1A of this report.*

Our Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is organized as follows:

- **Overview.** A discussion of our business and overall analysis of financial and other highlights in order to provide context for the remainder of MD&A.
- **Key Financial Metrics.** A summary of our GAAP and non-GAAP key financial metrics, which management monitors to evaluate our performance.
- **Results of Operations.** A discussion of the nature and trends in our financial results and an analysis of our financial results comparing fiscal 2017 to 2016 and fiscal 2016 to 2015.
- **Liquidity and Capital Resources.** An analysis of changes in our balance sheets and cash flows, and a discussion of our financial condition and our ability to meet cash needs.
- **Contractual Obligations and Commitments.** An overview of our contractual obligations, contingent liabilities, commitments, and off-balance sheet arrangements outstanding as of July 31, 2017, including expected payment schedules.
- **Critical Accounting Estimates.** A discussion of our accounting policies that require critical estimates, assumptions, and judgments.
- **Recent Accounting Pronouncements.** A discussion of expected impacts of impending accounting changes on financial information to be reported in the future.

### Overview

We have pioneered the next generation of security through our innovative platform that allows enterprises, service providers, and government entities to secure their organizations by safely enabling applications running on their networks and by preventing successful breaches that stem from targeted cyberattacks. Our platform uses an innovative traffic classification engine that identifies network traffic by application, user, and content and provides consistent security across the network, endpoint, and cloud. Accordingly, our platform enables our end-customers to maintain the visibility and control needed to protect their valued data and critical control systems while pursuing technology initiatives, like cloud and mobility, that grow their business. We believe our platform offers superior performance compared to legacy approaches and reduces the total cost of ownership for organizations by simplifying their security operations and infrastructure and eliminating the need for multiple, stand-alone security appliances and software products.

Our Next-Generation Security Platform consists of three major elements: our Next-Generation Firewall, our Advanced Endpoint Protection, and our Threat Intelligence Cloud. Our Next-Generation Firewall comes in several physical and cloud-based software form-factors and delivers application, user, and content visibility and control as well as protection against network-based cyberthreats integrated within the firewall through our proprietary hardware and software architecture. Our Advanced Endpoint Protection software prevents cyberattacks that aim to run malicious code or exploit software vulnerabilities on a broad variety of fixed, mobile, and virtual endpoints and servers. Our Threat Intelligence Cloud provides central intelligence capabilities, security for SaaS applications, and automated delivery of preventative measures against cyberattacks.

For fiscal 2017, 2016, and 2015, total revenue was \$1.8 billion, \$1.4 billion, and \$928.1 million, respectively, representing year-over-year growth of 27.8% for fiscal 2017 and 48.5% for fiscal 2016. Our growth reflects the increased adoption of our hybrid SaaS revenue model, which consists of product, subscriptions, and support. We believe this model will enable us to benefit from recurring revenues as we continue to grow our installed end-customer base. As of July 31, 2017, we had more than 42,500 end-customers in over 150 countries. Our end-customers represent a broad range of industries including education, energy, financial services, government entities, healthcare, Internet and media, manufacturing, public sector, and telecommunications, and include some of the largest Fortune 100 and Global 2000 companies in the world. We maintain a field sales force that works closely with our channel partners in developing sales opportunities. We use a two-tiered, indirect fulfillment model whereby we sell our products and services to our distributors, which, in turn, sell to our resellers, which then sell to our end-customers.

Our product revenue grew to \$709.1 million or 40.3% of total revenue for fiscal 2017, representing year-over-year growth of 5.7%. Product revenue is generated from sales of our appliances, primarily our Next-Generation Firewall, which is available in physical and virtualized form. Our Next-Generation Firewall incorporates our proprietary PAN-OS operating system, which provides a consistent set of capabilities across our entire product line. Our products are designed for different performance requirements throughout an organization, ranging from our PA-200, which is designed for enterprise remote offices, to our top-of-the-line PA-7080, which is especially suited for very large enterprise deployments and service provider customers. The same firewall functionality that is delivered in our physical appliances is also available in our VM-Series virtual firewalls, which secure virtualized and cloud-based computing environments.

Our subscription and support revenue grew to \$1.1 billion or 59.7% of total revenue for fiscal 2017, representing year-over-year growth of 48.7%. Our subscriptions provide our end-customers with real-time access to the latest antivirus, intrusion prevention, web filtering, and modern malware prevention capabilities across fixed and mobile devices. When end-customers purchase an appliance, they typically purchase one or more of our subscriptions for additional functionality, as well as support in order to receive ongoing security updates, upgrades, bug fixes, and repairs.

We continue to invest in and extend our platform, as we believe that innovation and timely development of new features and products is essential to meeting the needs of our end-customers and improving our competitive position. In February 2017, we expanded our family of firewalls with the launch of several new appliances: our PA-220, which is designed for small branch offices and remote locations; our PA-800 series, which are ideal for medium-sized networks and branch and remote office environments; our PA-5200 series, which deliver security for high throughput environments in a compact form factor; and three new VM-Series virtual firewall models, which support cloud and virtualization initiatives ranging from virtualized branch offices to data center and service provider deployments. We also delivered PAN-OS 8.0, an important software release that expands security for public and private clouds, provides new SaaS application security functionality, and also provides the capabilities to prevent the theft and abuse of stolen credentials. Additionally, in February 2017, we acquired LightCyber Ltd. ("LightCyber"), a privately-held cybersecurity company. LightCyber's technology expands the functionality of our platform through the addition of behavioral analytics, and will be the foundation for a new future subscription offering. We also expect to release two new cloud-based subscription offerings in September 2017: our GlobalProtect cloud service subscription, which provides our Next Generation Security Platform as a cloud-based service for remote offices and mobile users; and our Logging Service subscription, which functions as the central cloud-based repository for all application data and logs, and allows end-customers to collect data without needing to plan for local processing power and storage.

We plan to continue our investment in innovation as we evolve and further extend the capabilities of our platform. For example, in June 2017, we announced the next phase in the evolution of our Next-Generation Security Platform: our Palo Alto Networks Application Framework. Our cloud-based Application Framework will introduce a new SaaS consumption model under which our end-customers will be able to rapidly implement cloud-based security applications developed by us, third-party developers, or other security vendors, without having to deploy or manage additional products. We expect our Application Framework to become generally available in the early 2018 calendar year, with continuous and ongoing introduction of new security applications.

We believe that the growth of our business and our short-term and long-term success are dependent upon many factors, including our ability to extend our technology leadership, grow our base of end-customers, expand deployment of our platform and support offerings within existing end-customers, and focus on end-customer satisfaction. To manage any future growth effectively, we must continue to improve and expand our information technology and financial infrastructure, our operating and administrative systems and controls, and our ability to manage headcount, capital, and processes in an efficient manner. While these areas present significant opportunities for us, they also pose challenges and risks that we must successfully address in order to sustain the growth of our business and improve our operating results. For additional information regarding the challenges and risks we face, see the “Risk Factors” section in Part I, Item 1A of this Annual Report on Form 10-K.

## Key Financial Metrics

We monitor the key financial metrics set forth in the tables below to help us evaluate growth trends, establish budgets, measure the effectiveness of our sales and marketing efforts, and assess operational efficiencies. We discuss revenue, gross margin, and the components of operating loss and margin below under “—Results of Operations.”

	July 31,		
	2017	2016	
	(in millions)		
Total deferred revenue	\$ 1,773.5	\$ 1,240.8	
Cash, cash equivalents, and investments	\$ 2,164.3	\$ 1,938.4	
	Year Ended July 31,		
	2017	2016	2015
	(dollars in millions)		
Total revenue	\$ 1,761.6	\$ 1,378.5	\$ 928.1
Total revenue year-over-year percentage increase	27.8%	48.5%	55.1%
Gross margin	72.9%	73.2%	72.9%
Operating loss <sup>(1)</sup>	\$ (179.8)	\$ (157.3)	\$ (99.8)
Operating margin <sup>(1)</sup>	(10.2)%	(11.4)%	(10.8)%
Billings	\$ 2,293.4	\$ 1,905.6	\$ 1,219.1
Billings year-over-year percentage increase	20.4%	56.3%	58.0%
Cash flow provided by operating activities <sup>(2)</sup>	\$ 868.5	\$ 658.6	\$ 352.8
Free cash flow (non-GAAP) <sup>(2)</sup>	\$ 705.1	\$ 586.1	\$ 319.0

(1) Prior period amounts have been adjusted due to our voluntary change in accounting policy for sales commissions. Refer to Note 1. Description of Business and Summary of Significant Accounting Policies in Part II, Item 8 of this Annual Report on Form 10-K for more information.

(2) Prior period amounts have been adjusted due to our early adoption of new share-based payment accounting guidance. Refer to Note 1. Description of Business and Summary of Significant Accounting Policies in Part II, Item 8 of this Annual Report on Form 10-K for more information.

- **Deferred Revenue.** Our deferred revenue consists of amounts that have been invoiced but have not been recognized as revenue as of the period end. The majority of our deferred revenue balance consists of subscription and support revenue that is recognized ratably over the contractual service period. We monitor our deferred revenue balance because it represents a significant portion of revenue to be recognized in future periods.
- **Billings.** We define billings as total revenue plus the change in total deferred revenue, net of acquired deferred revenue, during the period. We consider billings to be a key measure used by management to manage our business given our hybrid SaaS revenue model, and believe billings provides investors

with an important indicator of the health and visibility of our business because it includes subscription and support revenue, which is recognized ratably over the contractual service period, and product revenue, which is recognized at the time of shipment, provided that all other revenue recognition criteria have been met. We consider billings to be a useful metric for management and investors, particularly if we continue to experience increased sales of subscriptions and strong renewal rates for subscription and support offerings, and as we monitor our near term cash flows. While we believe that billings provides useful information to investors and others in understanding and evaluating our operating results in the same manner as our management, it is important to note that other companies, including companies in our industry, may not use billings, may calculate billings differently, may have different billing frequencies, or may use other financial measures to evaluate their performance, all of which could reduce the usefulness of billings as a comparative measure. We calculate billings in the following manner:

	<u>Year Ended July 31,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
	(in millions)		
<b>Billings:</b>			
Total revenue	\$ 1,761.6	\$ 1,378.5	\$ 928.1
Add: change in total deferred revenue, net of acquired deferred revenue	<u>531.8</u>	<u>527.1</u>	<u>291.0</u>
Billings	<u>\$ 2,293.4</u>	<u>\$ 1,905.6</u>	<u>\$ 1,219.1</u>

- **Cash Flow Provided by Operating Activities.** We monitor cash flow provided by operating activities as a measure of our overall business performance. Our cash flow provided by operating activities is driven in large part by sales of our products and from up-front payments for subscription and support offerings. Monitoring cash flow provided by operating activities enables us to analyze our financial performance without the non-cash effects of certain items such as depreciation, amortization, and share-based compensation costs, thereby allowing us to better understand and manage the cash needs of our business.

- Free Cash Flow (non-GAAP).** We define free cash flow, a non-GAAP financial measure, as cash provided by operating activities less purchases of property, equipment, and other assets. We consider free cash flow to be a profitability and liquidity measure that provides useful information to management and investors about the amount of cash generated by the business after necessary capital expenditures. A limitation of the utility of free cash flow as a measure of our financial performance and liquidity is that it does not represent the total increase or decrease in our cash balance for the period. In addition, it is important to note that other companies, including companies in our industry, may not use free cash flow, may calculate free cash flow in a different manner than we do, or may use other financial measures to evaluate their performance, all of which could reduce the usefulness of free cash flow as a comparative measure. A reconciliation of free cash flow to cash flow provided by operating activities, the most directly comparable financial measure calculated and presented in accordance with GAAP, is provided below:

	<b>Year Ended July 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
	<b>(in millions)</b>		
<b>Free cash flow (non-GAAP):</b>			
Net cash provided by operating activities <sup>(1)</sup>	\$ 868.5	\$ 658.6	\$ 352.8
Less: purchases of property, equipment, and other assets	<u>163.4</u>	<u>72.5</u>	<u>33.8</u>
Free cash flow (non-GAAP) <sup>(1)</sup>	<u>\$ 705.1</u>	<u>\$ 586.1</u>	<u>\$ 319.0</u>
Net cash used in investing activities	<u>\$ (472.6)</u>	<u>\$ (338.9)</u>	<u>\$ (679.0)</u>
Net cash provided by (used in) financing activities <sup>(1)</sup>	<u>\$ (386.0)</u>	<u>\$ 38.9</u>	<u>\$ 48.2</u>

- 
- (1) Prior period amounts have been adjusted due to our early adoption of new share-based payment accounting guidance. Refer to Note 1. Description of Business and Summary of Significant Accounting Policies in Part II, Item 8 of this Annual Report on Form 10-K for more information.

## Results of Operations

The following table summarizes our results of operations for the periods presented and as a percentage of our total revenue for those periods based on our consolidated statements of operations data. The period to period comparison of results is not necessarily indicative of results for future periods.

	Year Ended July 31,					
	2017		2016		2015	
	Amount	% of Revenue	Amount <sup>(1)</sup>	% of Revenue <sup>(1)</sup>	Amount <sup>(1)</sup>	% of Revenue <sup>(1)</sup>
	(dollars in millions)					
Revenue:						
Product	\$ 709.1	40.3 %	\$ 670.8	48.7 %	\$ 492.7	53.1 %
Subscription and support	1,052.5	59.7 %	707.7	51.3 %	435.4	46.9 %
Total revenue	1,761.6	100.0 %	1,378.5	100.0 %	928.1	100.0 %
Cost of revenue:						
Product	201.4	11.4 %	175.4	12.7 %	131.1	14.1 %
Subscription and support	275.2	15.7 %	194.6	14.1 %	120.4	13.0 %
Total cost of revenue <sup>(2)</sup>	476.6	27.1 %	370.0	26.8 %	251.5	27.1 %
Total gross profit	1,285.0	72.9 %	1,008.5	73.2 %	676.6	72.9 %
Operating expenses:						
Research and development	347.4	19.7 %	284.2	20.6 %	185.8	20.0 %
Sales and marketing	919.1	52.2 %	743.2	53.9 %	489.0	52.7 %
General and administrative	198.3	11.2 %	138.4	10.1 %	101.6	11.0 %
Total operating expenses <sup>(2)</sup>	1,464.8	83.1 %	1,165.8	84.6 %	776.4	83.7 %
Operating loss	(179.8)	(10.2)%	(157.3)	(11.4)%	(99.8)	(10.8)%
Interest expense	(24.5)	(1.4)%	(23.4)	(1.7)%	(22.3)	(2.4)%
Other income, net	10.2	0.6 %	8.4	0.6 %	0.2	— %
Loss before income taxes	(194.1)	(11.0)%	(172.3)	(12.5)%	(121.9)	(13.2)%
Provision for income taxes	22.5	1.3 %	20.4	1.5 %	9.4	1.0 %
Net loss	\$ (216.6)	(12.3)%	\$ (192.7)	(14.0)%	\$ (131.3)	(14.2)%

(1) Certain prior period amounts have been adjusted due to our voluntary change in accounting policy for sales commissions. Refer to Note 1. Description of Business and Summary of Significant Accounting Policies in Part II, Item 8 of this Annual Report on Form 10-K for more information.

(2) Includes share-based compensation as follows:

	Year Ended July 31,		
	2017	2016	2015
	(in millions)		
Cost of product revenue	\$ 7.3	\$ 6.2	\$ 3.9
Cost of subscription and support revenue	56.2	40.9	20.4
Research and development	152.6	132.9	74.8
Sales and marketing	186.5	152.4	84.1
General and administrative	73.1	60.5	38.2
Total share-based compensation	\$ 475.7	\$ 392.9	\$ 221.4

## Revenue

Our revenue consists of product revenue and subscription and support revenue. Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectability is reasonably assured. We expect our revenue to vary from quarter to quarter based on seasonal and cyclical factors.

### Product Revenue

Product revenue is derived primarily from sales of our appliances. Product revenue also includes revenue derived from software licenses of Panorama and the VM-Series. We recognize product revenue at the time of shipment, provided that all other revenue recognition criteria have been met.

	<u>Year Ended July 31,</u>		<u>Change</u>		<u>Year Ended July 31,</u>		<u>Change</u>	
	<u>2017</u>	<u>2016</u>	<u>Amount</u>	<u>%</u>	<u>2016</u>	<u>2015</u>	<u>Amount</u>	<u>%</u>
	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>		<u>Amount</u>	<u>Amount</u>	<u>Amount</u>	
	(dollars in millions)							
Product	\$ 709.1	\$ 670.8	\$ 38.3	5.7%	\$ 670.8	\$ 492.7	\$ 178.1	36.2%

Product revenue increased year-over-year for fiscal 2017 due to demand for our newly introduced appliances. Product revenue increased year-over-year for fiscal 2016 due to increased demand for our higher end appliances. The change in product revenue due to pricing was not significant for either period.

### Subscription and Support Revenue

Subscription and support revenue is derived primarily from sales of our subscription and support offerings. Our contractual subscription and support terms are typically one to five years. We recognize revenue from subscriptions and support over the contractual service period. As a percentage of total revenue, we expect our subscription and support revenue to vary from quarter to quarter and increase over the long term as we introduce new subscriptions, renew existing subscription and support contracts, and expand our installed end-customer base. Prior to fiscal 2017, subscription and support revenue was referred to as services revenue. The composition of subscription and support revenue has not been modified.

	<u>Year Ended July 31,</u>		<u>Change</u>		<u>Year Ended July 31,</u>		<u>Change</u>	
	<u>2017</u>	<u>2016</u>	<u>Amount</u>	<u>%</u>	<u>2016</u>	<u>2015</u>	<u>Amount</u>	<u>%</u>
	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>		<u>Amount</u>	<u>Amount</u>	<u>Amount</u>	
	(dollars in millions)							
Subscription	\$ 550.8	\$ 357.0	\$ 193.8	54.3%	\$ 357.0	\$ 212.7	\$ 144.3	67.8%
Support	501.7	350.7	151.0	43.1%	350.7	222.7	128.0	57.5%
Total subscription and support	<u>\$ 1,052.5</u>	<u>\$ 707.7</u>	<u>\$ 344.8</u>	48.7%	<u>\$ 707.7</u>	<u>\$ 435.4</u>	<u>\$ 272.3</u>	62.5%

Subscription and support revenue increased year-over-year for both fiscal 2017 and fiscal 2016. The increases in both periods were due to increased demand for our subscription and support offerings from both new and existing end-customers. The mix between subscription revenue and support revenue will fluctuate over time, depending on the introduction of new subscription offerings, renewals of support services, and our ability to increase sales to new and existing customers. The change in subscription and support revenue due to changes in pricing was not significant for either period.

*Revenue by Geographic Theater*

	<u>Year Ended July 31,</u>		<u>Change</u>		<u>Year Ended July 31,</u>		<u>Change</u>	
	<u>2017</u>	<u>2016</u>	<u>Amount</u>	<u>%</u>	<u>2016</u>	<u>2015</u>	<u>Amount</u>	<u>%</u>
	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>	<u>%</u>
	(dollars in millions)							
Americas	\$ 1,237.4	\$ 973.2	\$ 264.2	27.1%	\$ 973.2	\$ 639.4	\$ 333.8	52.2%
EMEA	320.1	247.1	73.0	29.5%	247.1	178.7	68.4	38.2%
APAC	204.1	158.2	45.9	29.0%	158.2	110.0	48.2	43.8%
Total revenue	<u>\$ 1,761.6</u>	<u>\$ 1,378.5</u>	<u>\$ 383.1</u>	<u>27.8%</u>	<u>\$ 1,378.5</u>	<u>\$ 928.1</u>	<u>\$ 450.4</u>	<u>48.5%</u>

With respect to geographic theaters, the Americas contributed the largest portion of the year-over-year increases in revenue for both fiscal 2017 and fiscal 2016 due to its larger and more established sales force compared to our other theaters. Revenue from both EMEA and APAC increased year-over-year for both fiscal 2017 and fiscal 2016 due to our investment in increasing the size of our sales force and number of channel partners in these theaters.

***Cost of Revenue***

Our cost of revenue consists of cost of product revenue and cost of subscription and support revenue.

*Cost of Product Revenue*

Cost of product revenue primarily includes costs paid to our manufacturing partners. Our cost of product revenue also includes personnel costs, which consist of salaries, benefits, bonuses, share-based compensation, and travel and entertainment associated with our operations organization, amortization of intellectual property licenses, product testing costs, shipping costs, and allocated costs. Allocated costs consist of certain facilities, depreciation, benefits, recruiting, and information technology costs that we allocate based on headcount. We expect our cost of product revenue to increase as our product revenue increases.

	<u>Year Ended July 31,</u>		<u>Change</u>		<u>Year Ended July 31,</u>		<u>Change</u>	
	<u>2017</u>	<u>2016</u>	<u>Amount</u>	<u>%</u>	<u>2016</u>	<u>2015</u>	<u>Amount</u>	<u>%</u>
	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>	<u>%</u>
	(dollars in millions)							
Cost of product revenue	\$ 201.4	\$ 175.4	\$ 26.0	14.8%	\$ 175.4	\$ 131.1	\$ 44.3	33.8%
Number of employees at period end	96	91	5	5.5%	91	67	24	35.8%

Cost of product revenue increased for fiscal 2017 compared to fiscal 2016 primarily due to higher product costs related to our newly introduced appliances.

Cost of product revenue increased for fiscal 2016 compared to fiscal 2015 primarily due to an increase in product unit volume for our higher end appliances.



### Cost of Subscription and Support Revenue

Cost of subscription and support revenue includes personnel costs for our global customer support and technical operations organizations, customer support costs, third-party professional services costs, amortization of acquired intangible assets, and allocated costs. We expect our cost of subscription and support revenue to increase as our installed end-customer base grows. Prior to fiscal 2017, cost of subscription and support revenue was referred to as cost of services revenue. The composition of cost of subscription and support revenue has not been modified.

	Year Ended July 31,		Change		Year Ended July 31,		Change	
	2017	2016	Amount	%	2016	2015	Amount	%
	Amount	Amount			Amount	Amount		
(dollars in millions)								
Cost of subscription and support revenue	\$ 275.2	\$ 194.6	\$ 80.6	41.4%	\$ 194.6	\$ 120.4	\$ 74.2	61.7%
Number of employees at period end	725	539	186	34.5%	539	357	182	51.0%

Cost of subscription and support revenue increased for fiscal 2017 compared to fiscal 2016 primarily due to an increase in personnel costs, which grew \$45.3 million to \$155.4 million, largely due to headcount growth. The remaining increase was primarily driven by costs to expand our customer service capabilities and infrastructure, customer support costs, and allocated costs. The increase in allocated costs was primarily due to our expansion of facilities to support the growth of our business.

Cost of subscription and support revenue increased for fiscal 2016 compared to fiscal 2015 primarily due to an increase in personnel costs, which grew \$42.1 million to \$104.1 million, largely due to headcount growth. The remaining increase was due to expansion of our customer service capabilities and infrastructure to support our growing installed end-customer base.

### Gross Margin

Gross margin, or gross profit as a percentage of revenue, has been and will continue to be affected by a variety of factors, including the average sales price of our products, manufacturing costs, the introduction of new products, the mix of products sold, and the mix of revenue between product and subscription and support offerings. For sales of our products, our higher end firewall products generally have higher gross margins than our lower end firewall products within each product series. For sales of our subscription and support offerings, our subscription offerings typically have higher gross margins than our support offerings. We expect our gross margins to fluctuate over time depending on the factors described above.

	Year Ended July 31,					
	2017		2016		2015	
	Amount	Gross Margin	Amount	Gross Margin	Amount	Gross Margin
(dollars in millions)						
Product	\$ 507.7	71.6%	\$ 495.4	73.9%	\$ 361.6	73.4%
Subscription and support	777.3	73.9%	513.1	72.5%	315.0	72.3%
Total gross profit	\$ 1,285.0	72.9%	\$ 1,008.5	73.2%	\$ 676.6	72.9%

Product gross margin decreased for fiscal 2017 compared to fiscal 2016 due to higher product costs related to our newly introduced appliances, which will have lower product margins. Product gross margin increased for fiscal 2016 compared to fiscal 2015 due to our continued focus on material cost reductions.

Subscription and support gross margin increased for fiscal 2017 compared to fiscal 2016 due to contributions from our higher margin subscription offerings. Subscription and support gross margin was flat for fiscal 2016 compared to fiscal 2015.

## Operating Expenses

Our operating expenses consist of research and development, sales and marketing, and general and administrative expense. Personnel costs are the most significant component of operating expenses and consist of salaries, benefits, bonuses, share-based compensation, travel and entertainment, and with regard to sales and marketing expense, sales commissions. Our operating expenses also include allocated costs, which consist of certain facilities, depreciation, benefits, recruiting, and information technology costs that we allocate based on headcount. We expect operating expenses to increase in absolute dollars and decrease over the long term as a percentage of revenue as we continue to scale our business. As of July 31, 2017, we expect to recognize approximately \$906.8 million of share-based compensation expense over a weighted-average period of approximately 2.6 years, excluding additional share-based compensation expense related to any future grants of share-based awards. Share-based compensation expense is generally recognized on a straight-line basis over the requisite service periods of the awards.

### Research and Development

Research and development expense consists primarily of personnel costs. Research and development expense also includes prototype related expenses and allocated costs. We expect research and development expense to increase in absolute dollars as we continue to invest in our future products and services, although our research and development expense may fluctuate as a percentage of total revenue.

	Year Ended July 31,		Change		Year Ended July 31,		Change	
	2017	2016	Amount	%	2016	2015	Amount	%
	Amount	Amount	Amount	%	Amount	Amount	Amount	%
	(dollars in millions)							
Research and development	\$ 347.4	\$ 284.2	\$ 63.2	22.2%	\$ 284.2	\$ 185.8	\$ 98.4	52.9%
Number of employees at period end	766	637	129	20.3%	637	475	162	34.1%

Research and development expense increased year-over-year for both fiscal 2017 and fiscal 2016. The increases in both periods were driven by increases in personnel costs, which grew \$46.4 million to \$286.0 million for fiscal 2017 compared to fiscal 2016 and grew \$86.8 million to \$236.4 million for fiscal 2016 compared to fiscal 2015. The increases in personnel costs in both periods were primarily due to headcount growth. The remaining increase for fiscal 2017 was primarily driven by an increase in allocated costs, due to our expansion of facilities to support the growth of our business, and development costs related to investments in our new and future offerings.

### Sales and Marketing

Sales and marketing expense consists primarily of personnel costs, including commission expense. Sales and marketing expense also includes costs for market development programs, promotional and other marketing costs, professional services, and allocated costs. We continue to thoughtfully invest in headcount and have substantially grown our sales presence internationally. We expect sales and marketing expense to continue to increase in absolute dollars as we increase the size of our sales and marketing organizations to increase touch points with end-customers and to expand our international presence, although our sales and marketing expense may fluctuate as a percentage of total revenue.

	Year Ended July 31,		Change		Year Ended July 31,		Change	
	2017	2016	Amount	%	2016	2015	Amount	%
	Amount	Amount	Amount	%	Amount	Amount	Amount	%
	(dollars in millions)							
Sales and marketing <sup>(1)</sup>	\$ 919.1	\$ 743.2	\$ 175.9	23.7%	\$ 743.2	\$ 489.0	\$ 254.2	52.0%
Number of employees at period end	2,418	2,092	326	15.6%	2,092	1,443	649	45.0%

- (1) Prior period amounts have been adjusted due to our voluntary change in accounting policy for sales commissions. Refer to Note 1. Description of Business and Summary of Significant Accounting Policies in Part II, Item 8 of this Annual Report on Form 10-K for more information.

Sales and marketing expense increased year-over-year for both fiscal 2017 and fiscal 2016. The increases in both periods were driven by increases in personnel costs, which grew \$145.0 million to \$716.1 million for fiscal 2017 compared to fiscal 2016 and grew \$186.1 million to \$520.2 million for fiscal 2016 compared to fiscal 2015. The increases in personnel costs in both periods were primarily due to headcount growth. The remaining increase for fiscal 2017 was primarily driven by an increase in allocated costs, due to our expansion of facilities to support the growth of our business, and an increase in demand generation activities and sales related events to support our revenue growth.

#### *General and Administrative*

General and administrative expense consists primarily of personnel costs for our executive, finance, human resources, legal, and information technology organizations, and professional services costs, which consist primarily of legal, auditing, accounting, and other consulting costs. General and administrative expense also includes certain non-recurring general expenses and impairment losses. Certain facilities, depreciation, benefits, recruiting, and information technology costs are allocated to other organizations based on headcount. We expect general and administrative expense to increase in absolute dollars due to additional costs associated with accounting, compliance, insurance, and investor relations, although our general and administrative expense may fluctuate as a percentage of total revenue.

	Year Ended July 31,		Change		Year Ended July 31,		Change	
	2017	2016	Amount	%	2016	2015	Amount	%
	Amount	Amount	Amount	%	Amount	Amount	Amount	%
	(dollars in millions)							
General and administrative	\$ 198.3	\$ 138.4	\$ 59.9	43.3%	\$ 138.4	\$ 101.6	\$ 36.8	36.2%
Number of employees at period end	557	436	121	27.8%	436	295	141	47.8%

General and administrative expense increased for fiscal 2017 compared to fiscal 2016 primarily due to an increase in personnel costs, which grew \$29.3 million to \$128.1 million, largely due to headcount growth, and a fiscal 2017 impairment loss of \$20.9 million on property and equipment related to the relocation of our corporate headquarters. We expect to recognize a loss of approximately \$15.4 million on the lease of our previous headquarter facilities in the first quarter of fiscal 2018, when we officially cease use of such facilities. Refer to Note 9. Commitments and Contingencies and Note 18. Subsequent Events in Part II, Item 8 of this Annual Report on Form 10-K for more information. The remaining increase for fiscal 2017 was primarily driven by an increase in allocated costs due to our expansion of facilities to support the growth of our business.

General and administrative expense increased for fiscal 2016 compared to fiscal 2015 primarily due to an increase in personnel costs, which grew \$32.9 million to \$96.5 million, largely due to headcount growth.

#### *Other Income, Net*

Other income, net includes interest income earned on our cash, cash equivalents, and investments, foreign currency remeasurement gains and losses, and foreign currency transaction gains and losses.

	Year Ended July 31,		Change		Year Ended July 31,		Change	
	2017	2016	Amount	%	2016	2015	Amount	%
	Amount	Amount	Amount	%	Amount	Amount	Amount	%
	(dollars in millions)							
Other income, net	\$ 10.2	\$ 8.4	\$ 1.8	NM	\$ 8.4	\$ 0.2	\$ 8.2	NM

Other income, net increased for fiscal 2017 compared to fiscal 2016 due to an increase in interest income, partially offset by increased foreign currency remeasurement losses.

Other income, net increased for fiscal 2016 compared to fiscal 2015 due to an increase in interest income and higher foreign currency remeasurement gains.

### ***Provision for Income Taxes***

Provision for income taxes consists primarily of income taxes in foreign jurisdictions in which we conduct business, withholding taxes, federal and state income taxes in the United States, and amortization of our deferred tax charges. We maintain a full valuation allowance for domestic and certain foreign deferred tax assets, including net operating loss carryforwards and tax credits.

In recent years, we reorganized our corporate structure and intercompany relationships to more closely align with the international nature of our business activities. Our corporate structure has caused, and may continue to cause, disproportionate relationships between our overall effective tax rate and other jurisdictional measures.

	<u>Year Ended July 31,</u>		<u>Change</u>		<u>Year Ended July 31,</u>		<u>Change</u>	
	<u>2017</u>	<u>2016</u>			<u>2016</u>	<u>2015</u>		
	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>	<u>%</u>	<u>Amount</u>	<u>Amount</u>	<u>Amount</u>	<u>%</u>
	(dollars in millions)							
Provision for income taxes <sup>(1)</sup>	\$ 22.5	\$ 20.4	\$ 2.1	10.3%	\$ 20.4	\$ 9.4	\$ 11.0	117.0%
Effective tax rate <sup>(1)</sup>	(11.6)%	(11.8)%			(11.8)%	(7.7)%		

- (1) Prior period amounts have been adjusted due to our voluntary change in accounting policy for sales commissions. Refer to Note 1. Description of Business and Summary of Significant Accounting Policies in Part II, Item 8 of this Annual Report on Form 10-K for more information.

We recorded an income tax provision for fiscal 2017 due to foreign income taxes, withholding taxes, and amortization of our deferred tax charges. The provision for income taxes increased for fiscal 2017 compared to fiscal 2016 primarily due to increases in foreign withholding taxes and U.S. income taxes related to inter-company transactions, offset by tax benefits from our adoption of new share-based payment accounting guidance in fiscal 2017.

We recorded an income tax provision for fiscal 2016 due to federal, state, and foreign income taxes, withholding taxes, and amortization of our deferred tax charges. The provision for income taxes increased for fiscal 2016 compared to fiscal 2015 primarily due to an increase in foreign taxes and amortization of our deferred tax charges.

### **Liquidity and Capital Resources**

	<u>July 31,</u>	
	<u>2017</u>	<u>2016</u>
	(in millions)	
Working capital <sup>(1)</sup>	\$ 775.0	\$ 927.2
<b>Cash, cash equivalents, and investments:</b>		
Cash and cash equivalents	\$ 744.3	\$ 734.4
Investments	1,420.0	1,204.0
Total cash, cash equivalents, and investments	<u>\$ 2,164.3</u>	<u>\$ 1,938.4</u>

- (1) Prior period amount has been adjusted due to our voluntary change in accounting policy for sales commissions. Refer to Note 1. Description of Business and Summary of Significant Accounting Policies in Part II, Item 8 of this Annual Report on Form 10-K for more information.

At July 31, 2017, our total cash, cash equivalents, and investments of \$2.2 billion were held for general corporate purposes, of which approximately \$223.0 million was held outside of the United States. As of July 31, 2017, we had no unremitted earnings when evaluating our outside basis differences relating to our investment in foreign subsidiaries; accordingly, there is no restriction on the use of these funds.

As of July 31, 2017, all of the Notes remained outstanding. The Notes mature on July 1, 2019, however, prior to January 1, 2019, holders may surrender their Notes for early conversion under certain circumstances. Upon conversion, we will pay cash equal to the aggregate principal amount of the Notes to be converted, and, at our election, will pay or deliver cash and/or shares of our common stock for the amount of our conversion obligation in excess of the aggregate principal amount of the Notes being converted. Refer to Note 8. Convertible Senior Notes included in Part II, Item 8 of this Annual Report on Form 10-K for information on the Notes.

In August 2016, our board of directors authorized a \$500.0 million share repurchase and, in February 2017, authorized a \$500.0 million increase to our repurchase program, bringing the total authorization to \$1.0 billion. Repurchases are funded from available working capital and may be made at management's discretion from time to time. The repurchase authorization will expire on December 31, 2018, and may be suspended or discontinued at any time. As of July 31, 2017, \$580.0 million was available for future share repurchases under the repurchase authorization. Refer to Note 10. Stockholders' Equity in Part II, Item 8 of this Annual Report on Form 10-K for information on the repurchase authorization.

The following table summarizes our cash flows for the years ended July 31, 2017, 2016, and 2015:

	<b>Year Ended July 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
	<b>(in millions)</b>		
Net cash provided by operating activities <sup>(1)</sup>	\$ 868.5	\$ 658.6	\$ 352.8
Net cash used in investing activities	(472.6)	(338.9)	(679.0)
Net cash provided by (used in) financing activities <sup>(1)</sup>	(386.0)	38.9	48.2
Net increase (decrease) in cash and cash equivalents	<u>\$ 9.9</u>	<u>\$ 358.6</u>	<u>\$ (278.0)</u>

- (1) Prior period amounts have been adjusted due to our early adoption of new share-based payment accounting guidance. Refer to Note 1. Description of Business and Summary of Significant Accounting Policies in Part II, Item 8 of this Annual Report on Form 10-K for more information.

We believe that our cash flow from operations with existing cash and cash equivalents will be sufficient to meet our anticipated cash needs for the foreseeable future. Our future capital requirements will depend on many factors including our growth rate, the timing and extent of spending to support development efforts, the expansion of sales and marketing activities, the introduction of new and enhanced products and subscription and support offerings, the costs to acquire or invest in complementary businesses and technologies, the costs to ensure access to adequate manufacturing capacity, the investments in our new corporate headquarters, and the continuing market acceptance of our products and subscription and support offerings. In addition, from time to time we may incur additional tax liability in connection with certain corporate structuring decisions.

We may also choose to seek additional equity or debt financing. In the event that additional financing is required from outside sources, we may not be able to raise it on terms acceptable to us or at all. If we are unable to raise additional capital when desired, our business, operating results, and financial condition may be adversely affected.

### ***Operating Activities***

Our operating activities have consisted of net losses adjusted for certain non-cash items and changes in assets and liabilities.

Cash provided by operating activities in fiscal 2017 was \$868.5 million, an increase of \$209.9 million compared to fiscal 2016. The increase was due to growth of our business, as reflected by an increase in billings, and an increase in collections on accounts receivable during fiscal 2017.

Cash provided by operating activities in fiscal 2016 was \$658.6 million, an increase of \$305.8 million compared to fiscal 2015. The increase was due to growth of our business and changes in our assets and liabilities during fiscal 2016, which included an increase in sales of subscription and support contracts to new and existing customers as reflected by an increase in deferred revenue, and was partially offset by an increase in accounts receivable due to an increase in sales near the end of the period.

### *Investing Activities*

Our investing activities have consisted of capital expenditures, net investment purchases, sales, and maturities, and business acquisitions. We expect to continue such activities as our business grows.

Cash used in investing activities during fiscal 2017 was \$472.6 million, an increase of \$133.7 million compared to fiscal 2016, due to increased investment in facilities to support the growth of our business and a net cash payment of \$90.7 million for our acquisition of LightCyber, partially offset by lower net purchases of available-for-sale investments during fiscal 2017.

Cash used in investing activities during fiscal 2016 was \$338.9 million, a decrease of \$340.1 million compared to fiscal 2015, due to lower net purchases of available-for-sale investments and a payment of \$15.1 million related to our acquisition of CirroSecure in fiscal 2015, partially offset by increased investment in infrastructure and facilities to support the growth of our business.

### *Financing Activities*

Our financing activities have consisted of proceeds from sales of shares through employee equity incentive plans, cash used to repurchase shares of our common stock, and payments for tax withholding obligations of certain employees related to the net share settlement of equity awards.

Cash used in financing activities during fiscal 2017 was \$386.0 million, a change of \$424.9 million compared to fiscal 2016, due to the repurchase of \$411.0 million of our common stock and payments for tax withholding obligations of certain employees related to the net share settlement of equity awards of \$21.4 million during fiscal 2017.

Cash provided by financing activities during fiscal 2016 was \$38.9 million, a decrease of \$9.3 million compared to fiscal 2015, due to a payment of deferred consideration related to our acquisition of Cyvera and lower proceeds from the sale of shares through employee equity incentive plans.

### **Contractual Obligations and Commitments**

The following summarizes our contractual obligations and commitments as of July 31, 2017:

	Payments Due by Period				
	Total	Less Than 1 Year	1-3 Years (in millions)	3-5 Years	More Than 5 Years
0.0% Convertible Senior Notes due 2019	\$ 575.0	\$ —	\$ 575.0	\$ —	\$ —
Operating lease obligations <sup>(1)</sup>	517.5	31.0	110.8	111.2	264.5
Purchase obligations <sup>(2)</sup>	104.1	98.5	5.6	—	—
Total <sup>(3)</sup>	<u>\$ 1,196.6</u>	<u>\$ 129.5</u>	<u>\$ 691.4</u>	<u>\$ 111.2</u>	<u>\$ 264.5</u>

(1) Consists of contractual obligations from our non-cancelable operating leases. Excludes contractual sublease proceeds of \$2.1 million, which will be received in less than one year. Refer to Note 9. Commitments and Contingencies of Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report on Form 10-K for more information on our operating leases.

(2) Consists of minimum purchase commitments of products and components with our manufacturing partners and component suppliers. Obligations under contracts that we can cancel without a significant penalty are not included in the table above.

- (3) No amounts related to income taxes are included. As of July 31, 2017, we had approximately \$62.2 million of tax liabilities recorded related to uncertainty in income tax positions.

### **Off-Balance Sheet Arrangements**

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

### **Critical Accounting Estimates**

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

The critical accounting policies requiring estimates, assumptions, and judgments that we believe have the most significant impact on our consolidated financial statements are described below.

#### ***Revenue Recognition***

We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectability is reasonably assured. Most of our arrangements, other than renewals of subscriptions and support contracts, are multiple-element arrangements with a combination of hardware, software, subscriptions, support, and other services. For multiple-element arrangements, we allocate revenue to each unit of accounting based on an estimated selling price at the arrangement inception. The estimated selling price for each element is based upon the following hierarchy:

- Vendor-specific objective evidence (“VSOE”) of selling price, if available,
- Third-party evidence (“TPE”) of selling price, if VSOE of selling price is not available, or
- Best estimate of selling price (“BESP”), if neither VSOE of selling price nor TPE of selling price are available.

We establish VSOE of selling price using the prices charged for a deliverable when sold separately. We establish TPE of selling price by evaluating similar and interchangeable competitor products or services in stand-alone arrangements with similarly situated partners. We establish BESP primarily based on historical transaction pricing, whereby historical transactions are segregated based on our pricing model and our go-to-market strategy, which include factors such as type of sales channel (reseller, distributor, or end-customer), the geographies in which our products and services were sold (domestic or international), and offering type (products or services). To further support BESP as determined by the historical transaction pricing or when such information is unavailable, such as when there are limited sales of a new product or service, we consider the same factors we have established through our pricing model and go-to-market strategy. The determination of BESP is made through consultation with and approval by our management. In determining BESP, we rely on certain assumptions and apply significant judgment. As our business offerings evolve over time, we may be required to modify our estimated selling prices in subsequent periods, and the timing of our revenue recognition could be affected.

#### ***Income Taxes***

We account for income taxes using the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in our financial statements or tax returns. In addition, deferred tax assets are recorded for the future benefit of utilizing net operating losses and research and development credit carryforwards. Valuation allowances are provided when necessary to reduce deferred tax assets to the amount expected to be realized.

Significant judgment is required in determining any valuation allowance recorded against deferred tax assets. In assessing the need for a valuation allowance, we consider all available evidence, including past operating results, estimates of future taxable income, and the feasibility of tax planning strategies. In the event that we change our determination as to the amount of deferred tax assets that can be realized, we will adjust our valuation allowance with a corresponding impact to the provision for income taxes in the period in which such determination is made.

We apply the authoritative accounting guidance prescribing a threshold and measurement attribute for the financial recognition and measurement of a tax position taken or expected to be taken in a tax return. We recognize liabilities for uncertain tax positions based on a two-step process. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step requires us to estimate and measure the tax benefit as the largest amount that is more likely than not to be realized upon ultimate settlement.

Significant judgment is also required in evaluating our uncertain tax positions and determining our provision for income taxes. Although we believe our reserves are reasonable, no assurance can be given that the final tax outcome of these matters will not be different from that which is reflected in our historical income tax provisions and accruals. We adjust these reserves in light of changing facts and circumstances, such as the closing of a tax audit or the refinement of an estimate. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences may impact the provision for income taxes in the period in which such determination is made.

#### ***Manufacturing Partner and Supplier Liabilities***

We outsource most of our manufacturing, repair, and supply chain management operations to our EMS provider, which procures components and assembles our products based on our demand forecasts. These forecasts of future demand are based upon historical trends and analysis from our sales and product management functions as adjusted for overall market conditions. We accrue for costs for manufacturing purchase commitments in excess of our forecasted demand, including costs for excess components or for carrying costs incurred by our manufacturing partners and component suppliers. Actual component usage and product demand may be materially different from our forecast, and could be caused by factors outside of our control, which could have an adverse impact on our results of operations. To date, we have not accrued significant costs associated with this exposure.

#### ***Loss Contingencies***

We are subject to the possibility of various loss contingencies arising in the ordinary course of business. We accrue for loss contingencies when it is probable that an asset has been impaired or a liability has been incurred and the amount of loss can be reasonably estimated. If we determine that a loss is possible and the range of the loss can be reasonably determined, then we disclose the range of the possible loss. We regularly evaluate current information available to us to determine whether an accrual is required, an accrual should be adjusted or a range of possible loss should be disclosed.

From time to time, we are involved in disputes, litigation, and other legal actions. However, there are many uncertainties associated with any litigation, and these actions or other third-party claims against us may cause us to incur substantial settlement charges, which are inherently difficult to estimate and could adversely affect our results of operations. The actual liability in any such matters may be materially different from our estimates, which could result in the need to adjust our liability and record additional expenses.

#### ***Goodwill, Intangibles, and Other Long-Lived Assets***

We make significant estimates, assumptions, and judgments when valuing goodwill and other purchased intangible assets in connection with the initial purchase price allocation of an acquired entity, as well as when evaluating impairment of goodwill and other purchased intangible assets on an ongoing basis. These estimates are based upon a number of factors, including historical experience, market conditions, and information obtained



from the management of the acquired company. Critical estimates in valuing certain intangible assets include, but are not limited to, cash flows that an asset is expected to generate in the future, discount rates, the time and expense that would be necessary to recreate the assets, and the profit margin a market participant would receive. The amounts and useful lives assigned to identified intangible assets impacts the amount and timing of future amortization expense.

We evaluate goodwill for impairment on an annual basis in our fourth fiscal quarter or more frequently if we believe impairment indicators exist. We have elected to first assess qualitative factors to determine whether it is more likely than not that the fair value of our reporting unit is less than its carrying amount, including goodwill. The qualitative assessment includes our evaluation of relevant events and circumstances affecting our single reporting unit, including macroeconomic, industry, and market conditions, our overall financial performance, and trends in the market price of our common stock. If qualitative factors indicate that it is more likely than not that our reporting unit's fair value is less than its carrying amount, then we will perform the quantitative impairment test by comparing our reporting unit's carrying amount, including goodwill, to its fair value. If the carrying amount of our reporting unit exceeds its fair value, an impairment loss will be recognized in an amount equal to that excess. To date, the results of our qualitative assessment have indicated that the quantitative goodwill impairment test is not necessary.

We evaluate long-lived assets, such as property, equipment, and purchased intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Such events or changes in circumstances include, but are not limited to, a significant decrease in the fair value of the underlying asset or asset group, a significant decrease in the benefits realized from the acquired assets, difficulty and delays in integrating the business, or a significant change in the operations of the acquired assets or use of an asset or asset group. A long-lived asset is considered impaired if its carrying amount exceeds the estimated future undiscounted cash flows the asset or asset group is expected to generate. Critical estimates in determining whether a long-lived asset is considered impaired include the amount and timing of future cash flows that the asset or asset group is expected to generate. If a long-lived asset is considered to be impaired, the impairment to be recognized is the amount by which the carrying amount of the asset exceeds the fair value of the asset or asset group, which is estimated using a present value technique. Critical estimates in determining the fair value of an asset or asset group and the amount of impairment to recognize include, but are not limited to, the amount and timing of future cash flows that the asset or asset group is expected to generate and the discount rate. Determining the fair value of an asset or asset group is highly judgmental in nature and involves the use of significant estimates and assumptions for market participants. We base our fair value estimates on assumptions we believe to be reasonable but that are unpredictable and inherently uncertain. Actual future results may differ from those estimates.

To date, we have not recognized any impairment losses on our goodwill and intangible assets. In fiscal 2017, we recognized an impairment loss of \$20.9 million on property and equipment related to the relocation of our corporate headquarters. We did not recognize any impairment losses on our other long-lived assets prior to fiscal 2017.

### **Recent Accounting Pronouncements**

Refer to "Recently Issued Accounting Pronouncements" in Note 1. Description of Business and Summary of Significant Accounting Policies of Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report on Form 10-K.

## **ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

### **Foreign Currency Exchange Risk**

Our sales contracts are primarily denominated in U.S. dollars. A portion of our operating expenses are incurred outside of the United States and are denominated in foreign currencies and are subject to fluctuations due to changes in foreign currency exchange rates, particularly changes in the euro, British pound, Singapore dollar, Israeli shekel, and Japanese yen. Additionally, fluctuations in foreign currency exchange rates may cause

us to recognize transaction gains and losses in our statement of operations. The effect of an immediate 10% adverse change in foreign exchange rates on monetary assets and liabilities at July 31, 2017 would not be material to our financial condition or results of operations. As of July 31, 2017, foreign currency transaction gains and losses and exchange rate fluctuations have not been material to our financial statements. We enter into foreign currency derivative contracts with maturities of 12 months or less which we designate as cash flow hedges to manage the foreign currency exchange rate risk associated with our foreign currency denominated expenditures. The effectiveness of our existing hedging transactions and the availability and effectiveness of any hedging transactions we may decide to enter into in the future may be limited and we may not be able to successfully hedge our exposure, which could adversely affect our financial condition and operating results. Refer to Note 4. Derivative Instruments in Part II, Item 8 of this Annual Report on Form 10-K for more information.

As our international operations grow, our risks associated with fluctuation in currency rates will become greater, and we will continue to reassess our approach to managing this risk. In addition, a weakening U.S. dollar can increase the costs of our international expansion and a strengthening U.S. dollar can increase the real cost of our products to our end-customers outside of the United States, leading to delays in the purchase of our products and services. For additional information, see the risk factor entitled “We are exposed to fluctuations in currency exchange rates, which could negatively affect our financial condition and operating results” in Part 1, Item 1A of this Annual Report on Form 10-K.

### **Interest Rate Risk**

The primary objectives of our investment activities are to preserve principal, provide liquidity, and maximize income without significantly increasing risk. Some of the securities we invest in are subject to interest risk. To minimize this risk, we maintain our portfolio of cash, cash equivalents, and short-term investments in a variety of securities, including commercial paper, money market funds, U.S. government and agency securities, and corporate debt securities. Due to the short duration and conservative nature of our investment portfolio, a movement of 10% in market interest rates would not have a material impact on our operating results and the total value of the portfolio. The effect of an immediate 10% change in interest rates at July 31, 2017 would not have been material to our operating results and the total value of the portfolio assuming consistent investment levels.

### **Market Risk and Market Interest Risk**

In June 2014, we issued \$575.0 million aggregate principal amount of 0.0% Convertible Senior Notes due 2019 (the “Notes”). We carry this instrument at face value less unamortized discount and unamortized issuance costs on our consolidated balance sheets. As this instrument does not bear interest, we have no financial and economic interest exposure associated with changes in interest rates. However, the fair value of fixed rate instruments fluctuates when interest rates change, and additionally, in the case of the Notes, when the market price of our common stock fluctuates.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders  
Palo Alto Networks, Inc.

We have audited the accompanying consolidated balance sheets of Palo Alto Networks, Inc. as of July 31, 2017 and 2016, and the related consolidated statements of operations, comprehensive loss, stockholders' equity and cash flows for each of the three years in the period ended July 31, 2017. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Palo Alto Networks, Inc. at July 31, 2017 and 2016, and the consolidated results of its operations and its cash flows for each of the three years in the period ended July 31, 2017, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, in the second quarter of fiscal 2017, the Company changed its method of accounting for share-based payments as a result of the adoption of the amendments to the FASB Accounting Standards Codification resulting from Accounting Standards Update No. 2016-09, "Improvements to Employee Share-Based Payment Accounting".

As discussed in Note 1 to the consolidated financial statements, in the first quarter of fiscal 2017, the Company elected to change its method of accounting for sales commissions that are incremental and directly related to non-cancelable customer sales contracts from recording an expense when incurred, to deferral and amortization of the sales commissions over the term of the related contracts in proportion to the recognized revenue.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Palo Alto Networks, Inc.'s internal control over financial reporting as of July 31, 2017, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated September 7, 2017 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

San Jose, California  
September 7, 2017

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders  
Palo Alto Networks, Inc.

We have audited Palo Alto Networks, Inc.'s internal control over financial reporting as of July 31, 2017, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). Palo Alto Networks, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Palo Alto Networks, Inc. maintained, in all material respects, effective internal control over financial reporting as of July 31, 2017, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Palo Alto Networks, Inc. as of July 31, 2017 and 2016, and the related consolidated statements of operations, comprehensive loss, stockholders' equity and cash flows for each of the three years in the period ended July 31, 2017 of Palo Alto Networks, Inc. and our report dated September 7, 2017 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

San Jose, California  
September 7, 2017

## MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

### Management's Report on Internal Control Over Financial Reporting

The management of Palo Alto Networks, Inc. (the "Company") is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934 for the Company. The Company's internal control over financial reporting is a process designed under the supervision of the Company's principal executive and principal financial officers to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

The Company's internal control over financial reporting includes those policies and procedures that:

- (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and
- (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the Consolidated Financial Statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of the Company's internal control over financial reporting as of July 31, 2017, based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control—Integrated Framework (2013 framework). Based on that assessment, management concluded that, as of July 31, 2017, the Company's internal control over financial reporting was effective.

The effectiveness of the Company's internal control over financial reporting as of July 31, 2017, has been audited by Ernst & Young LLP, the independent registered public accounting firm that audits the Company's Consolidated Financial Statements, as stated in their report preceding this report, which expresses an unqualified opinion on the effectiveness of the Company's internal control over financial reporting as of July 31, 2017.

**PALO ALTO NETWORKS, INC.**

**CONSOLIDATED BALANCE SHEETS**  
(In millions, except per share data)

	July 31,	
	2017	2016
		(As Adjusted)
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 744.3	\$ 734.4
Short-term investments	630.7	551.2
Accounts receivable, net of allowance for doubtful accounts of \$0.7 and \$2.4 at July 31, 2017 and July 31, 2016, respectively	432.1	348.7
Prepaid expenses and other current assets	169.2	139.7
Total current assets	1,976.3	1,774.0
Property and equipment, net	211.1	117.2
Long-term investments	789.3	652.8
Goodwill	238.8	163.5
Intangible assets, net	53.7	44.0
Other assets	169.1	106.7
Total assets	\$ 3,438.3	\$ 2,858.2
<b>Liabilities and stockholders' equity</b>		
Current liabilities:		
Accounts payable	\$ 35.5	\$ 30.2
Accrued compensation	117.5	73.5
Accrued and other liabilities	79.9	39.2
Deferred revenue	968.4	703.9
Total current liabilities	1,201.3	846.8
Convertible senior notes, net	524.7	500.2
Long-term deferred revenue	805.1	536.9
Other long-term liabilities	147.6	79.4
Commitments and contingencies (Note 9)		
Stockholders' equity:		
Preferred stock; \$0.0001 par value; 100.0 shares authorized; none issued and outstanding at July 31, 2017 and July 31, 2016	—	—
Common stock and additional paid-in capital; \$0.0001 par value; 1,000.0 shares authorized; 91.5 and 90.5 shares issued and outstanding at July 31, 2017 and July 31, 2016, respectively	1,599.7	1,515.5
Accumulated other comprehensive income (loss)	(3.4)	1.0
Accumulated deficit	(836.7)	(621.6)
Total stockholders' equity	759.6	894.9
Total liabilities and stockholders' equity	\$ 3,438.3	\$ 2,858.2

*See notes to consolidated financial statements.*

**PALO ALTO NETWORKS, INC.**

**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(In millions, except per share data)

	Year Ended July 31,		
	2017	2016	2015
		(As Adjusted)	(As Adjusted)
Revenue:			
Product	\$ 709.1	\$ 670.8	\$ 492.7
Subscription and support	1,052.5	707.7	435.4
Total revenue	1,761.6	1,378.5	928.1
Cost of revenue:			
Product	201.4	175.4	131.1
Subscription and support	275.2	194.6	120.4
Total cost of revenue	476.6	370.0	251.5
Total gross profit	1,285.0	1,008.5	676.6
Operating expenses:			
Research and development	347.4	284.2	185.8
Sales and marketing	919.1	743.2	489.0
General and administrative	198.3	138.4	101.6
Total operating expenses	1,464.8	1,165.8	776.4
Operating loss	(179.8)	(157.3)	(99.8)
Interest expense	(24.5)	(23.4)	(22.3)
Other income, net	10.2	8.4	0.2
Loss before income taxes	(194.1)	(172.3)	(121.9)
Provision for income taxes	22.5	20.4	9.4
Net loss	<u>\$ (216.6)</u>	<u>\$ (192.7)</u>	<u>\$ (131.3)</u>
Net loss per share, basic and diluted	<u>\$ (2.39)</u>	<u>\$ (2.21)</u>	<u>\$ (1.61)</u>
Weighted-average shares used to compute net loss per share, basic and diluted	<u>90.6</u>	<u>87.1</u>	<u>81.6</u>

*See notes to consolidated financial statements.*



**PALO ALTO NETWORKS, INC.**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**  
**(In millions)**

	Year Ended July 31,		
	2017	2016	2015
		(As Adjusted)	(As Adjusted)
Net loss	\$ (216.6)	\$ (192.7)	\$ (131.3)
Other comprehensive income (loss), net of tax:			
Change in unrealized gains (losses) on investments	(4.3)	1.1	—
Change in unrealized gains (losses) on cash flow hedges	(0.1)	—	—
Other comprehensive income (loss)	(4.4)	1.1	—
Comprehensive loss	<u>\$ (221.0)</u>	<u>\$ (191.6)</u>	<u>\$ (131.3)</u>

*See notes to consolidated financial statements.*

PALO ALTO NETWORKS, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
(In millions)

	Common Stock and Additional Paid-In Capital		Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit (As Adjusted)	Total Stockholders' Equity (As Adjusted)
	Shares	Amount			
Balance as of July 31, 2014	79.5	\$ 804.4	\$ (0.1)	\$ (297.6)	\$ 506.7
Net loss	—	—	—	(131.3)	(131.3)
Issuance of common stock in connection with employee equity incentive plans and related excess tax benefit	5.3	50.9	—	—	50.9
Share-based compensation for equity based awards	—	221.3	—	—	221.3
Temporary equity reclassification	—	(87.9)	—	—	(87.9)
Balance as of July 31, 2015	84.8	988.7	(0.1)	(428.9)	559.7
Net loss	—	—	—	(192.7)	(192.7)
Other comprehensive income	—	—	1.1	—	1.1
Issuance of common stock in connection with employee equity incentive plans and related excess tax benefit	5.7	45.8	—	—	45.8
Share-based compensation for equity based awards	—	393.1	—	—	393.1
Temporary equity reclassification	—	87.9	—	—	87.9
Balance as of July 31, 2016	90.5	1,515.5	1.0	(621.6)	894.9
Cumulative-effect adjustment from adoption of new accounting pronouncement	—	2.0	—	1.5	3.5
Net loss	—	—	—	(216.6)	(216.6)
Other comprehensive loss	—	—	(4.4)	—	(4.4)
Issuance of common stock in connection with employee equity incentive plans	4.3	46.3	—	—	46.3
Repurchase and retirement of common stock	(3.3)	(420.1)	—	—	(420.1)
Taxes paid related to net share settlement of equity awards	—	(21.4)	—	—	(21.4)
Share-based compensation for equity based awards	—	477.4	—	—	477.4
Balance as of July 31, 2017	91.5	\$ 1,599.7	\$ (3.4)	\$ (836.7)	\$ 759.6

*See notes to consolidated financial statements.*

**PALO ALTO NETWORKS, INC.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In millions)

	Year Ended July 31,		
	2017	2016	2015
		(As Adjusted)	(As Adjusted)
<b>Cash flows from operating activities</b>			
Net loss	\$ (216.6)	\$ (192.7)	\$ (131.3)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Share-based compensation for equity based awards	474.5	392.8	221.3
Depreciation and amortization	59.8	42.8	28.9
Asset impairment related to facility exit	20.9	—	—
Amortization of investment premiums, net of accretion of purchase discounts	2.7	3.0	3.2
Amortization of debt discount and debt issuance costs	24.5	23.4	22.3
Changes in operating assets and liabilities, net of effects of acquisitions:			
Accounts receivable, net	(82.9)	(136.4)	(76.8)
Prepaid expenses and other assets	(48.1)	(31.2)	(69.0)
Accounts payable	5.9	15.1	(3.5)
Accrued compensation	42.8	(6.3)	31.1
Accrued and other liabilities	53.2	21.0	35.6
Deferred revenue	531.8	527.1	291.0
Net cash provided by operating activities	868.5	658.6	352.8
<b>Cash flows from investing activities</b>			
Purchases of investments	(995.9)	(1,037.0)	(987.6)
Proceeds from sales of investments	—	141.9	18.5
Proceeds from maturities of investments	777.4	628.7	339.0
Business acquisitions, net of cash acquired	(90.7)	—	(15.1)
Purchases of property, equipment, and other assets	(163.4)	(72.5)	(33.8)
Net cash used in investing activities	(472.6)	(338.9)	(679.0)
<b>Cash flows from financing activities</b>			
Repurchases of common stock	(411.0)	—	—
Proceeds from sales of shares through employee equity incentive plans	46.4	45.3	48.2
Payments for taxes related to net share settlement of equity awards	(21.4)	—	—
Payment of deferred consideration related to prior year business acquisition	—	(6.4)	—
Net cash provided by (used in) financing activities	(386.0)	38.9	48.2
Net increase (decrease) in cash and cash equivalents	9.9	358.6	(278.0)
Cash and cash equivalents—beginning of period	734.4	375.8	653.8
Cash and cash equivalents—end of period	\$ 744.3	\$ 734.4	\$ 375.8
<b>Supplemental disclosures of cash flow information</b>			
Cash paid for income taxes	\$ 9.0	\$ 7.1	\$ 17.5

*See notes to consolidated financial statements.*

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1. Description of Business and Summary of Significant Accounting Policies

#### *Description of Business*

Palo Alto Networks, Inc. (the “Company,” “we,” “us,” or “our”), located in Santa Clara, California, was incorporated in March 2005 under the laws of the State of Delaware and commenced operations in April 2005. We offer a next-generation security platform that empowers enterprises, service providers, and government entities to secure their organizations by safely enabling applications running on their networks and by preventing breaches that stem from targeted cyberattacks.

#### *Basis of Presentation*

The accompanying consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles (“GAAP”). The consolidated financial statements include all adjustments necessary for a fair presentation of our annual results. All adjustments are of a normal recurring nature. Certain prior period amounts have been adjusted due to our voluntary change in accounting policy for sales commissions, our early adoption of new accounting guidance related to share-based payments, and our adoption of new accounting guidance related to debt issuance costs. Refer to “Change in Accounting Policy for Sales Commissions” and “Recently Adopted Accounting Pronouncements” below for more information.

#### *Principles of Consolidation*

The consolidated financial statements include our accounts and our wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

#### *Use of Estimates*

The preparation of consolidated financial statements in conformity with U.S. 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 revenues and expenses during the reporting period. Such management estimates include, but are not limited to the best estimate of selling price for our products and services, share-based compensation, fair value of assets acquired and liabilities assumed in business combinations, the assessment of recoverability of our property and equipment, identified intangibles and goodwill, future taxable income, manufacturing partner and supplier liabilities, and loss contingencies. We base our estimates on historical experience and also on assumptions that we believe are reasonable. Actual results could differ materially from those estimates.

#### *Concentrations*

Financial instruments that subject us to concentrations of credit risk consist primarily of cash and cash equivalents, investments, accounts receivable, and derivative contracts.

We invest only in high-quality credit instruments and maintain our cash and cash equivalents and available-for-sale investments in fixed income securities. Management believes that the financial institutions that hold our investments are financially sound and, accordingly, are subject to minimal credit risk. Deposits held with banks may exceed the amount of insurance provided on such deposits.

Our derivative contracts expose us to credit risk to the extent that the counterparties may be unable to meet the terms of the arrangement. We mitigate this credit risk by transacting with major financial institutions with high credit ratings and also enter into master netting arrangements, which permit net settlement of transactions with the same counterparty. We are not required to pledge, and are not entitled to receive, cash collateral related to these derivative instruments. We do not enter into derivative contracts for trading or speculative purposes.

Our accounts receivables are primarily derived from our distributors representing various geographical locations. We perform ongoing credit evaluations and generally do not require collateral on accounts receivable. We

maintain an allowance for doubtful accounts for estimated potential credit losses. As of July 31, 2017, four distributors represented 28.5%, 21.2%, 15.0%, and 11.2% of our gross accounts receivable. For fiscal 2017, three distributors represented 32.4%, 23.3%, and 10.0% of our total revenue.

We rely on an electronics manufacturing services provider (“EMS provider”) to assemble most of our products and sole source component suppliers for a certain number of our components.

### ***Comprehensive Loss***

Comprehensive loss is comprised of net loss and other comprehensive income (loss). Our other comprehensive income (loss) includes unrealized gains and losses on available-for-sale investments and unrealized gains and losses on cash flow hedges.

### ***Foreign Currency Transactions***

The functional currency of our foreign subsidiaries is the U.S. dollar. Monetary assets and liabilities denominated in foreign currencies have been remeasured into U.S. dollars using the exchange rates in effect at the balance sheet dates. Foreign currency denominated income and expenses have been remeasured using the average exchange rates in effect during each period. Foreign currency remeasurement gains and losses and foreign currency transaction gains and losses are not significant to the financial statements.

### ***Fair Value***

We define fair value as 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. When determining the fair value measurements for assets and liabilities which are required to be recorded at fair value, we consider the principal or most advantageous market in which to transact and the market-based risk. We apply fair value accounting for all financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis. Goodwill, intangible assets, and other long-lived assets are measured at fair value on a non-recurring basis, only if impairment is indicated. The carrying amounts reported in the consolidated financial statements approximate the fair value for cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities, due to their short-term nature.

### ***Cash, Cash Equivalents, and Investments***

We classify our investments as available-for-sale at the time of purchase since it is our intent that these investments are available for current operations, and include these investments on our consolidated balance sheets as cash equivalents, short-term investments, or long-term investments depending on their maturity.

We consider all highly liquid investments with original maturities of three months or less at date of purchase to be cash equivalents. Investments not considered cash equivalents and with maturities one year or less from the consolidated balance sheet date are classified as short-term investments. Investments with maturities greater than one year from the consolidated balance sheet date are classified as long-term investments.

Investments are considered impaired when a decline in fair value is judged to be other-than-temporary. We consult with our investment managers and consider available quantitative and qualitative evidence in evaluating potential impairment of our investments on a quarterly basis. If the cost of an individual investment exceeds its fair value, we evaluate, among other factors, general market conditions, the duration and extent to which the fair value is less than cost, and our intent and ability to hold the investment. Once a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded and a new cost basis in the investment is established.

### ***Accounts Receivable***

Trade accounts receivable are recorded at the invoiced amount, net of allowances for doubtful accounts. The allowance for doubtful accounts is based on our assessment of the collectability of accounts. Management regularly reviews the adequacy of the allowance for doubtful accounts by considering the age of each outstanding

invoice, each channel partner's expected ability to pay, and the collection history with each channel partner, when applicable, to determine whether a specific allowance is appropriate. Accounts receivable deemed uncollectible are charged against the allowance for doubtful accounts when identified. As of July 31, 2017 and 2016, the allowance for doubtful accounts activity was not significant.

### ***Derivatives***

Our derivative financial instruments are recorded at fair value, on a gross basis, as either assets or liabilities in our consolidated balance sheets. Gains or losses related to the effective portion of our cash flow hedges are recorded as a component of accumulated other comprehensive income ("AOCI") in our consolidated balance sheets and are reclassified into the financial statement line item associated with the underlying hedged transaction in our consolidated statements of operations when the underlying hedged transaction is recognized in earnings. Any gains or losses related to the ineffective portion of our cash flow hedges are recorded immediately in other income (expense), net in our consolidated statements of operations. If it becomes probable that the hedged transaction will not occur, the cumulative unrealized gain or loss is reclassified immediately from AOCI into other income (expense), net. Gains or losses related to non-designated derivative instruments are recognized in other income (expense), net each period until the instrument matures, is terminated, is re-designated as a qualified cash flow hedge, or is sold. Derivatives designated as cash flow hedges are classified in our consolidated statements of cash flows in the same manner as the underlying hedged transaction, primarily within cash flows from operating activities.

### ***Property and Equipment***

Property and equipment are stated at cost, less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally three to ten years. Leasehold improvements are depreciated over the shorter of the estimated useful lives of the improvements or the remaining lease term.

### ***Business Combinations***

We include the results of operations of the businesses that we acquire as of the respective dates of acquisition. We allocate the fair value of the purchase price of our acquisitions to the tangible assets acquired, liabilities assumed, and intangible assets acquired, based on their estimated fair values. The excess of the purchase price over the fair values of these identifiable assets and liabilities is recorded as goodwill. Additional information existing as of the acquisition date but unknown to us may become known during the remainder of the measurement period, not to exceed 12 months from the acquisition date, which may result in changes to the amounts and allocations recorded.

### ***Intangible Assets***

Purchased intangible assets with finite lives are carried at cost, less accumulated amortization. Amortization is computed over the estimated useful lives of the respective assets. Acquisition-related in-process research and development represents the fair value of incomplete research and development projects that have not reached technological feasibility as of the date of acquisition. Initially, these assets are not subject to amortization. Assets related to projects that have been completed are transferred to developed technology, which are subject to amortization.

### ***Impairment of Goodwill, Intangible Assets, and Other Long-Lived Assets***

Goodwill is evaluated for impairment on an annual basis in the fourth quarter of our fiscal year, and whenever events or changes in circumstances indicate the carrying amount of goodwill may not be recoverable. We have elected to first assess qualitative factors to determine whether it is more likely than not that the fair value of our single reporting unit is less than its carrying amount, including goodwill. If we determine that it is more likely than not that the fair value of our single reporting unit is less than its carrying amount, then the quantitative impairment test will be performed. Under the quantitative impairment test, if the carrying amount of our single

reporting unit exceeds its fair value, we will recognize an impairment loss in an amount equal to that excess, but limited to the total amount of goodwill.

We evaluate events and changes in circumstances that could indicate carrying amounts of purchased intangible assets and other long-lived assets may not be recoverable. When such events or changes in circumstances occur, we assess the recoverability of these assets by determining whether or not the carrying amount will be recovered through undiscounted expected future cash flows. If the total of the future undiscounted cash flows is less than the carrying amount of an asset, we record an impairment loss for the amount by which the carrying amount of the asset exceeds the fair value of the asset.

Through July 31, 2017, we have not recognized any impairment losses on our goodwill and intangible assets. During the year ended July 31, 2017, we recognized an impairment loss of \$20.9 million on property and equipment related to the relocation of our corporate headquarters. We did not recognize any impairment losses on our other long-lived assets prior to fiscal 2017.

### ***Manufacturing Partner and Supplier Liabilities***

We outsource most of our manufacturing, repair, and supply chain management operations to our EMS provider and payments to it are a significant portion of our cost of product revenue. Although we could be contractually obligated to purchase manufactured products and components, we generally do not own the manufactured products and components. Product title transfers from our EMS provider to us and immediately to our channel partners upon shipment. Our EMS provider assembles our products using design specifications, quality assurance programs, and standards that we establish and it procures components and assembles our products based on our demand forecasts. These forecasts represent our estimates of future demand for our products based upon historical trends and analysis from our sales and product management functions as adjusted for overall market conditions. If the actual component usage and product demand are significantly lower than forecast, we record a liability for manufacturing purchase commitments in excess of our forecasted demand including costs for excess components or for carrying costs incurred by our manufacturing partners and component suppliers. Through July 31, 2017, we have not accrued any significant costs associated with this exposure.

### ***Convertible Senior Notes***

On June 30, 2014, we issued \$575.0 million aggregate principal amount of 0.0% Convertible Senior Notes due 2019 (the "Notes"). In accounting for the issuance of the Notes, we separated the Notes into liability and equity components. The carrying amount 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 as a whole. This difference represents a debt discount that is amortized to interest expense using the effective interest method over the term of the Notes. 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 using the same proportions as the proceeds from the Notes. Transaction costs attributable to the liability component are netted with the liability component and are being amortized to interest expense using the effective interest method over the term of the Notes. Transaction costs attributable to the equity component are netted with the equity component of the Notes in additional paid-in capital in the consolidated balance sheets. When the Notes are convertible, the net carrying amount of the Notes will be classified as a current liability and a portion of the equity component representing the conversion option will be reclassified to temporary equity in our consolidated balance sheets.

### ***Revenue Recognition***

We generate revenue from the sales of hardware and software products, subscriptions, support, and other services primarily through a direct sales force and indirect relationships with channel partners, and, to a lesser extent, directly to end-customers.

Revenue is recognized when all of the following criteria are met:

- ***Persuasive Evidence of an Arrangement Exists.*** We rely upon non-cancelable sales agreements and purchase orders to determine the existence of an arrangement.
- ***Delivery has Occurred.*** We use shipping documents or transmissions of product or subscription and support contract registration codes to determine delivery.
- ***The Fee is Fixed or Determinable.*** We assess whether the fee is fixed or determinable based on the payment terms associated with the transaction.
- ***Collectability is Reasonably Assured.*** We assess collectability based on credit analysis and payment history.

We recognize product revenue at the time of shipment provided that all other revenue recognition criteria have been met. Our channel partners generally receive an order from an end-customer prior to placing an order with us. In addition, payment from our channel partners is not contingent on the partner's success in sales to end-customers. Our channel partners generally do not stock appliances and only have limited stock rotation rights and no price protection rights. When necessary, we make certain estimates and maintain allowances for sales returns and other programs based on our historical experience. To date, these estimates have not been significant. We recognize subscription and support revenue ratably over the contractual service period, which is typically one to five years. Other services revenue is recognized as the services are rendered.

Most of our arrangements, other than renewals of subscriptions and support contracts, are multiple-element arrangements with a combination of hardware, software, subscriptions, support, and other services. Products, subscriptions, support, and other services generally qualify as separate units of accounting. Our hardware deliverables typically include proprietary operating system software, which together deliver the essential functionality of our products. For multiple-element arrangements, we allocate revenue to each unit of accounting based on an estimated selling price at the arrangement inception. The estimated selling price for each element is based upon the following hierarchy: vendor-specific objective evidence ("VSOE") of selling price, if available, third-party evidence ("TPE") of selling price, if VSOE of selling price is not available, or best estimate of selling price ("BESP"), if neither VSOE of selling price nor TPE of selling price are available. The total arrangement consideration is allocated to each separate unit of accounting using the relative estimated selling prices of each unit based on the aforementioned selling price hierarchy. We limit the amount of revenue recognized for delivered elements to an amount that is not contingent upon future delivery of additional products or services or meeting of any specified performance conditions.

In multiple-element arrangements where software deliverables are included, revenue is allocated to each separate unit of accounting for each of the non-software deliverables and to the software deliverables as a group using the relative estimated selling prices of each of the deliverables in the arrangement based on the aforementioned estimated selling price hierarchy. The arrangement consideration allocated to the software deliverables as a group is then allocated to each software deliverable using the residual method when VSOE of fair value of the undelivered items exists. Under the residual method, the amount of revenue allocated to delivered elements equals the total arrangement consideration less the aggregate fair value of any undelivered elements. In determining VSOE of fair value, we evaluate whether a substantial majority of the historical prices charged for a product or service sold on a standalone basis, as represented by a percentage of list price, fall within a reasonably narrow range. If VSOE of fair value of one or more undelivered items does not exist, revenue from the software portion of the arrangement is deferred and recognized at the earlier of: (i) delivery of those elements or (ii) when fair value can be established unless support is the only undelivered element, in which case, the entire software arrangement fee is recognized ratably over the contractual service period.

We account for multiple agreements with a single partner as one arrangement if the contractual terms and/or substance of those agreements indicate that they may be so closely related that they are, in effect, parts of a single arrangement.

Revenues are reported net of sales taxes. Shipping charges billed to channel partners are included in revenues and related costs are included in cost of revenue. After receipt of a partner order, any amounts billed in excess of revenue recognized are recorded as deferred revenue.



### ***Deferred Commissions***

Sales commissions that are incremental and directly related to non-cancelable customer sales contracts are deferred and amortized over the term of the related contract in proportion to the recognized revenue. Refer to “Change in Accounting Policy for Sales Commissions” below for more information.

### ***Advertising Costs***

Advertising costs, which are expensed and included in sales and marketing expense when incurred, were \$13.7 million, \$6.6 million, and \$4.8 million, during the years ended July 31, 2017, 2016, and 2015, respectively.

### ***Software Development Costs***

Internally developed software includes security software developed to meet our internal needs to provide cloud-based subscription services to our end-customers and business software that we customize to meet our specific operational needs. These capitalized costs consist of internal compensation related costs and external direct costs incurred during the application development stage and will be amortized over a useful life of three to five years.

The costs to develop software that is marketed externally have not been capitalized as we believe our current software development process is essentially completed concurrent with the establishment of technological feasibility. As such, all related software development costs are expensed as incurred and included in research and development expense in our consolidated statements of operations.

### ***Share-Based Compensation***

Compensation expense related to share-based transactions, including employee and non-employee director awards, is measured and recognized in the financial statements based on fair value on the grant date. We recognize share-based compensation expense for awards with only service conditions on a straight-line basis over the requisite service period of the related award and recognize share-based compensation expense for awards with performance conditions on a straight-line basis over the requisite service period for each separately vesting portion of the award when it is probable that the performance condition will be achieved. We account for forfeitures of all share-based payment awards when they occur.

### ***Leases***

We rent our facilities under operating lease agreements and recognize related rent expense on a straight-line basis over the term of the lease. Some of our lease agreements contain rent holidays, scheduled rent increases, lease incentives, and renewal options. Rent holidays and scheduled rent increases are included in the determination of rent expense to be recorded over the lease term. Lease incentives are recognized as a reduction of rent expense on a straight-line basis over the term of the lease. Renewals are not assumed in the determination of the lease term unless they are deemed to be reasonably assured at the inception of the lease. We begin recognizing rent expense on the date that we obtain the legal right to use and control the leased space.

### ***Income Taxes***

We account for income taxes using the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in our financial statements or tax returns. In addition, deferred tax assets are recorded for the future benefit of utilizing net operating losses and research and development credit carryforwards. Valuation allowances are provided when necessary to reduce deferred tax assets to the amount expected to be realized.

Significant judgment is required in determining any valuation allowance recorded against deferred tax assets. In assessing the need for a valuation allowance, we consider all available evidence, including past operating results, estimates of future taxable income, and the feasibility of tax planning strategies. In the event that we change our determination as to the amount of deferred tax assets that can be realized, we will adjust our valuation allowance with a corresponding impact to the provision for income taxes in the period in which such determination is made.

We apply the authoritative accounting guidance prescribing a threshold and measurement attribute for the financial recognition and measurement of a tax position taken or expected to be taken in a tax return. We recognize liabilities for uncertain tax positions based on a two-step process. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step requires us to estimate and measure the tax benefit as the largest amount that is more likely than not to be realized upon ultimate settlement.

We record deferred tax charges in prepaid expenses and other current assets and other assets on our consolidated balance sheets. These deferred tax charges are amortized on a straight-line basis over the life of the associated assets as a component of provision for income taxes in our consolidated statements of operations.

### ***Loss Contingencies***

We are subject to the possibility of various loss contingencies arising in the ordinary course of business. In determining loss contingencies, we consider the likelihood of loss or impairment of an asset, or the incurrence of a liability, as well as our ability to reasonably estimate the amount of loss. An estimated loss contingency is accrued when it is probable that an asset has been impaired or a liability has been incurred and the amount of loss can be reasonably estimated. If we determine that a loss is possible and the range of the loss can be reasonably determined, then we disclose the range of the possible loss. We regularly evaluate current information available to us to determine whether an accrual is required, an accrual should be adjusted or a range of possible loss should be disclosed.

### ***Change in Accounting Policy for Sales Commissions***

Effective August 1, 2016, we voluntarily changed our accounting policy for sales commissions that are incremental and directly related to non-cancelable customer sales contracts from recording an expense when incurred to deferral and amortization of the sales commissions over the term of the related contract in proportion to the recognized revenue. We believe this change in accounting policy is preferable as the direct and incremental commission costs are closely related to the associated revenue, and therefore should be deferred and recognized as an expense over the same period that the related revenue is recognized.

Short-term deferred commissions are included in prepaid expenses and other current assets, while long-term deferred commissions are included in other assets in our consolidated balance sheets. The amortization of deferred commissions is included in sales and marketing expense in our consolidated statements of operations.

The adoption of this accounting policy change has been applied retrospectively to all prior periods presented in this Annual Report on Form 10-K, in which the cumulative effect of the change of \$38.1 million has been reflected in accumulated deficit as of August 1, 2014, the beginning of the earliest period presented.

The following tables present the changes to financial statement line items as a result of the accounting policy change for the periods presented in our consolidated financial statements (in millions, except per share data):

	July 31, 2017			July 31, 2016		
	Computed under Prior Method	Impact of Commission Adjustment	As Reported	As Previously Reported	Impact of Commission Adjustment	As Adjusted
<b>Consolidated Balance Sheets</b>						
Prepaid expenses and other current assets	\$ 95.8	\$ 73.4	\$ 169.2	\$ 84.8	\$ 54.9	\$ 139.7
Other assets	97.8	71.3	169.1	64.6	50.1	114.7
Accumulated deficit	\$ (981.4)	\$ 144.7	\$ (836.7)	\$ (726.6)	\$ 105.0	\$ (621.6)

	<u>Year Ended July 31, 2017</u>		
	<u>Computed under Prior Method</u>	<u>Impact of Commission Adjustment</u>	<u>As Reported</u>
<b>Consolidated Statements of Operations</b>			
Sales and marketing	\$ 958.4	\$ (39.3)	\$ 919.1
Operating loss	(219.1)	39.3	(179.8)
Provision for income taxes	22.9	(0.4)	22.5
Net loss	\$ (256.3)	\$ 39.7	\$ (216.6)
Net loss per share, basic and diluted	\$ (2.83)	\$ 0.44	\$ (2.39)
Weighted-average shares used to compute net loss per share, basic and diluted	90.6	—	90.6
<b>Consolidated Statements of Comprehensive Loss</b>			
Net loss	\$ (256.3)	\$ 39.7	\$ (216.6)
Comprehensive loss	\$ (260.7)	\$ 39.7	\$ (221.0)
	<u>Year Ended July 31, 2016</u>		
	<u>As Previously Reported</u>	<u>Impact of Commission Adjustment</u>	<u>As Adjusted</u>
<b>Consolidated Statements of Operations</b>			
Sales and marketing	\$ 776.0	\$ (32.8)	\$ 743.2
Operating loss	(190.1)	32.8	(157.3)
Provision for income taxes	20.8	(0.4)	20.4
Net loss	\$ (225.9)	\$ 33.2	\$ (192.7)
Net loss per share, basic and diluted	\$ (2.59)	\$ 0.38	\$ (2.21)
Weighted-average shares used to compute net loss per share, basic and diluted	87.1	—	87.1
<b>Consolidated Statements of Comprehensive Loss</b>			
Net loss	\$ (225.9)	\$ 33.2	\$ (192.7)
Comprehensive loss	\$ (224.8)	\$ 33.2	\$ (191.6)
	<u>Year Ended July 31, 2015</u>		
	<u>As Previously Reported</u>	<u>Impact of Commission Adjustment</u>	<u>As Adjusted</u>
<b>Consolidated Statements of Operations</b>			
Sales and marketing	\$ 522.7	\$ (33.7)	\$ 489.0
Operating loss	(133.5)	33.7	(99.8)
Provision for income taxes	9.4	—	9.4
Net loss	\$ (165.0)	\$ 33.7	\$ (131.3)
Net loss per share, basic and diluted	\$ (2.02)	\$ 0.41	\$ (1.61)
Weighted-average shares used to compute net loss per share, basic and diluted	81.6	—	81.6
<b>Consolidated Statements of Comprehensive Loss</b>			
Net loss	\$ (165.0)	\$ 33.7	\$ (131.3)
Comprehensive loss	\$ (165.0)	\$ 33.7	\$ (131.3)

This change in accounting policy does not affect our balance of cash and cash equivalents and, as a result, did not change net cash flows from operating, investing, or financing activities, or materially impact any individual line items presented in our consolidated statement of cash flows for the years ended July 31, 2016 and 2015.

### ***Recently Adopted Accounting Pronouncements***

#### *Goodwill Impairment*

In January 2017, the Financial Accounting Standards Board (“FASB”) issued authoritative guidance simplifying the subsequent measurement of goodwill. The standard eliminates Step 2 of the current goodwill impairment test, which requires companies to determine the implied fair value of goodwill when measuring the amount of impairment loss. Under the new standard, goodwill impairment will be measured as the amount by which a reporting unit’s carrying value exceeds its fair value, with the loss limited to the total amount of goodwill allocated to that reporting unit. We elected to early adopt the standard in our fourth quarter of fiscal 2017 on a prospective basis. Our adoption of this standard did not have an impact on our consolidated financial statements.

#### *Share-Based Payment Accounting*

In March 2016, the FASB issued authoritative guidance simplifying several aspects of the accounting for employee share-based payment transactions. The new standard requires us to recognize excess tax benefits or deficiencies as income tax expense or benefit in the period in which they occur, rather than additional paid-in capital, and also requires us to recognize excess tax benefits regardless of whether the benefit reduces taxes payable in the current period. In addition, excess tax benefits should be classified as an operating activity, along with other income tax cash flows, instead of a financing activity in our consolidated statements of cash flows. The standard also allows us to make an accounting policy election to account for forfeitures of share-based payment awards when they occur, rather than estimate expected forfeitures.

We elected to early adopt the standard in our second quarter of fiscal 2017, which required us to reflect any adjustments related to the adoption as of the beginning of the fiscal year. The impact of the adoption on our consolidated financial statements was as follows:

- *Income tax accounting*—We adopted the guidance related to the timing of when excess tax benefits are recognized on a modified retrospective basis. As a result, we recorded the cumulative effect of the change as a \$3.5 million reduction to accumulated deficit as of August 1, 2016, to reflect the recognition of excess tax benefits in prior years, with a corresponding adjustment to deferred tax assets and long-term tax liabilities. We adopted the guidance related to the recognition of excess tax benefits and deficiencies as income tax expense or benefit on a prospective basis.
- *Cash flow presentation of excess tax benefits*—We elected to adopt the guidance related to the presentation of excess tax benefits in our consolidated statements of cash flows on a retrospective basis, which increased net cash provided by operating activities by \$0.5 million and \$2.5 million for the years ended July 31, 2016 and 2015, respectively, with corresponding decreases to net cash provided by financing activities.
- *Forfeitures*—We elected to account for forfeitures when they occur and adopted this change on a modified retrospective basis. As a result, we recorded the cumulative effect of the change as a \$2.0 million increase to accumulated deficit as of August 1, 2016.

The adoption of the standard also impacted our previously reported results for the three months ended October 31, 2016, as presented in the following tables (in millions, except per share data):

	October 31, 2016		
	As Previously Reported	Impact of Adoption	As Adjusted
<b>Consolidated Balance Sheets</b>			
Other assets	\$ 102.0	\$ 1.7	\$ 103.7
Other long-term liabilities	85.8	(5.6)	80.2
Common stock and additional paid-in capital	1,542.2	0.9	1,543.1
Accumulated deficit	\$ (683.4)	\$ 6.4	\$ (677.0)
<b>Three Months Ended October 31, 2016</b>			
	As Previously Reported	Impact of Adoption	As Adjusted
<b>Consolidated Statements of Operations</b>			
Total cost of revenue <sup>(1)</sup>	\$ 101.3	\$ (0.1)	\$ 101.2
Total operating expenses <sup>(1)</sup>	346.7	(0.8)	345.9
Provision for income taxes	8.4	(4.0)	4.4
Net loss	\$ (61.8)	\$ 4.9	\$ (56.9)
Net loss per share, basic and diluted	\$ (0.69)	\$ 0.06	\$ (0.63)
Weighted-average shares used to compute net loss per share, basic and diluted	89.8	—	89.8
<b>Consolidated Statements of Comprehensive Loss</b>			
Net loss	\$ (61.8)	\$ 4.9	\$ (56.9)
Comprehensive loss	\$ (64.7)	\$ 4.9	\$ (59.8)
<b>Consolidated Statements of Cash Flows</b>			
Net cash provided by operating activities	\$ 203.3	\$ 0.2	\$ 203.5
Net cash used in financing activities	\$ (27.1)	\$ (0.2)	\$ (27.3)

(1) Adjustments consist of share-based compensation, which was impacted by our policy election to account for forfeitures when they occur. The impact of adoption on each cost and expense line item within these subtotals was not significant.

#### *Cloud Computing Arrangements*

In April 2015, the FASB issued new authoritative guidance on fees paid in a cloud computing arrangement. The standard requires customers in a cloud computing arrangement to evaluate whether the arrangement includes a software license. If the arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If the arrangement does not include a software license, the customer should account for the arrangement as a service contract. We adopted the standard in our first quarter of fiscal 2017 on a prospective basis. Our adoption of this standard did not have a material impact on our consolidated financial statements.

#### *Debt Issuance Costs*

In April 2015, the FASB issued updated authoritative guidance to simplify the presentation of debt issuance costs. The amended standard 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 the related debt liability, consistent with the presentation of debt discounts, instead of being presented as an asset. We adopted the standard in our first

quarter of fiscal 2017 on a retrospective basis, and as a result, we reduced other assets and convertible senior notes, net by \$8.0 million on our consolidated balance sheets as of July 31, 2016.

### ***Recently Issued Accounting Pronouncements***

#### *Business Combinations—Definition of a Business*

In January 2017, the FASB issued authoritative guidance clarifying the definition of a business to assist companies with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The standard is effective for us for our first quarter of fiscal 2019 and will be applied on a prospective basis. Early adoption is permitted. We do not expect the adoption of the standard will have a material impact on our consolidated financial statements.

#### *Statement of Cash Flows—Restricted Cash*

In November 2016, the FASB issued authoritative guidance on the presentation of restricted cash or restricted cash equivalents in the statement of cash flows. Under the new standard, restricted cash or restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The standard is effective for us for our first quarter of fiscal 2019 and will be applied on a retrospective basis. Early adoption is permitted. We do not expect the adoption of the standard will have a material impact on our consolidated financial statements because our restricted cash balance has not been material.

#### *Income Taxes—Intra-Entity Asset Transfers*

In October 2016, the FASB issued authoritative guidance requiring the recognition of income tax consequences of an intra-entity transfer of an asset, other than inventory, when the transfer occurs. The standard is effective for us for our first quarter of fiscal 2019 and will be applied on a modified retrospective basis. Early adoption is permitted. We plan to adopt the standard in our first quarter of fiscal 2019 and are currently evaluating whether this standard will have a material impact on our consolidated financial statements.

#### *Statement of Cash Flows—Classification of Certain Cash Receipts and Cash Payments*

In August 2016, the FASB issued new authoritative guidance addressing eight specific cash flow issues with the objective of reducing the existing diversity in practice in how certain transactions are presented and classified in the statement of cash flows. The standard is effective for us for our first quarter of fiscal 2019 and will be applied on a retrospective basis. Early adoption is permitted. We do not expect the adoption of the standard will have a material impact on our consolidated financial statements.

#### *Financial Instruments—Credit Losses*

In June 2016, the FASB issued new authoritative guidance on the accounting for credit losses on most financial assets and certain financial instruments. The standard replaces the existing incurred loss model with an expected credit loss model for financial assets measured at amortized cost, including trade receivables, and requires that credit losses on available-for-sale debt securities be presented as an allowance rather than as a write-down. The standard is effective for us for our first quarter of fiscal 2021 and will be applied on a modified retrospective basis. Early adoption is permitted beginning our first quarter of fiscal 2020. We are currently evaluating whether this standard will have a material impact on our consolidated financial statements.

#### *Leases*

In February 2016, the FASB issued new authoritative guidance on lease accounting. Among its provisions, the standard requires lessees to recognize right-of-use assets and lease liabilities on the balance sheet for operating leases and also requires additional qualitative and quantitative disclosures about lease arrangements. The standard is effective for us for our first quarter of fiscal 2020 and will be applied on a modified retrospective basis, with the option to elect certain practical expedients. Early adoption is permitted. We are currently evaluating whether this standard will have a material impact on our consolidated financial statements.

### *Revenue Recognition*

In May 2014, the FASB issued new authoritative guidance on revenue from contracts with customers. The new standard provides principles for recognizing revenue for the transfer of promised goods or services to customers with the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard also requires significantly expanded disclosures about revenue recognition. The FASB subsequently delayed the effective date of the standard by one year and as a result, the standard is now effective for us for our first quarter of fiscal 2019 using either of two methods: (i) retrospective to each prior reporting period presented with the option to elect certain practical expedients as defined within the guidance (“full retrospective method”); or (ii) retrospective with the cumulative effect of initially applying the guidance recognized at the date of initial application and providing certain additional disclosures as defined per the guidance (“modified retrospective method”). Early adoption as of the original effective date is permitted.

We do not plan to early adopt the new standard, and accordingly, we will adopt the standard in our first quarter of fiscal 2019. We currently plan to adopt using the full retrospective method, however, our ability to apply the full retrospective method is dependent on system readiness and the completion of our analysis of information necessary to restate prior period financial statements.

We are continuing to evaluate the impact of the new standard on our accounting policies, processes, internal controls over financial reporting, and system requirements, and have assigned cross-functional internal resources and engaged third-party service providers to assist in our evaluation and system implementation. Furthermore, we have made and will continue to make investments in systems to enable timely and accurate reporting under the new standard.

We are also continuing to evaluate the impact the standard will have on our consolidated financial statements, including reviewing the provisions of our customer contracts and identifying performance obligations under the requirements of the new standard and comparing to our current accounting policies and practices. Although we have not yet determined whether the effect will be material, we believe the new standard will impact our accounting for revenue arrangements in the following areas:

- removal of the current limitation on contingent revenue may result in revenue being recognized earlier for certain contracts;
- term license revenue associated with our virtual firewalls will be recognized upfront;
- allocation of revenue related to software due to the removal of the residual method of revenue recognition; and
- amortization period for deferred commissions.

We will continue to assess the new standard along with industry trends and additional interpretive guidance, and may adjust our implementation plan accordingly.

## **2. Fair Value Measurements**

We categorize assets and liabilities recorded or disclosed at fair value on our consolidated balance sheets based upon the level of judgment associated with inputs used to measure their fair value. The categories are as follows:

- Level 1—Inputs are unadjusted quoted prices in active markets for identical assets or liabilities.
- Level 2—Inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the assets or liabilities, either directly or indirectly through market corroboration, for substantially the full term of the financial instruments.
- Level 3—Inputs are unobservable inputs based on our own assumptions used to measure assets and liabilities at fair value. The inputs require significant management judgment or estimation.

The following table presents the fair value of our financial assets and liabilities measured at fair value on a recurring basis using the above input categories as of July 31, 2017 and July 31, 2016 (in millions):

	July 31, 2017				July 31, 2016			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Short-term investments:								
Commercial paper	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 3.0	\$ —	\$ 3.0
Corporate debt securities	—	159.4	—	159.4	—	121.4	—	121.4
U.S. government and agency securities	—	471.3	—	471.3	—	426.8	—	426.8
Total short-term investments	—	630.7	—	630.7	—	551.2	—	551.2
Long-term investments:								
Certificates of deposit	—	5.4	—	5.4	—	5.4	—	5.4
Corporate debt securities	—	186.5	—	186.5	—	166.1	—	166.1
U.S. government and agency securities	—	597.4	—	597.4	—	481.3	—	481.3
Total long-term investments	—	789.3	—	789.3	—	652.8	—	652.8
Total assets measured at fair value	\$ —	\$ 1,420.0	\$ —	\$ 1,420.0	\$ —	\$ 1,204.0	\$ —	\$ 1,204.0

As of July 31, 2017, we determined that certain property and equipment related to our prior corporate headquarters were impaired. In connection with our planned relocation to our new corporate headquarters, we assessed the recoverability of certain leasehold improvements and other long-lived assets associated with our previous headquarter facilities and determined that the carrying amount of these assets exceeded their fair value of \$4.2 million. The resulting impairment loss of \$20.9 million was recorded as general and administrative expense in our consolidated statements of operations during the year ended July 31, 2017. We calculated the fair value of the leasehold improvements and other long-lived assets based on estimated future discounted cash flows and classified the fair value as a Level 3 measurement due to the significance of unobservable inputs, which included the amount and timing of estimated sublease rental receipts that we could reasonably obtain over the remaining lease term and the discount rate. Refer to Note 9. Commitments and Contingencies for more information on the relocation of our corporate headquarters.

Refer to Note 8. Convertible Senior Notes for the carrying amount and estimated fair value of our convertible senior notes as of July 31, 2017 and July 31, 2016.

### 3. Investments

The following tables summarize the amortized cost, unrealized gains and losses, and fair value of our available-for-sale investments as of July 31, 2017 and July 31, 2016 (in millions):

	July 31, 2017			Estimated Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
Certificates of deposit	\$ 5.4	\$ —	\$ —	\$ 5.4
Corporate debt securities	346.1	0.3	(0.5)	345.9
U.S. government and agency securities	1,071.2	0.1	(2.6)	1,068.7
Total	\$ 1,422.7	\$ 0.4	\$ (3.1)	\$ 1,420.0



	<b>July 31, 2016</b>			
	<u>Amortized Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Estimated Fair Value</u>
Certificates of deposit	\$ 5.4	\$ —	\$ —	\$ 5.4
Commercial paper	3.0	—	—	3.0
Corporate debt securities	286.7	0.8	—	287.5
U.S. government and agency securities	907.3	0.9	(0.1)	908.1
Total	<u>\$ 1,202.4</u>	<u>\$ 1.7</u>	<u>\$ (0.1)</u>	<u>\$ 1,204.0</u>

Unrealized losses related to these investments are due to interest rate fluctuations as opposed to credit quality. In addition, we do not intend to sell and it is not likely that we would be required to sell these investments before recovery of their amortized cost basis, which may be at maturity. As a result, there were no other-than-temporary impairments for these investments at July 31, 2017 and 2016.

We received proceeds of \$141.9 million and \$18.5 million from sales of investments during the years ended July 31, 2016 and 2015, respectively. We did not sell any investments during the year ended July 31, 2017. We use the specific identification method to determine the cost basis of investments sold.

The following table summarizes the amortized cost and fair value of our available-for-sale investments as of July 31, 2017, by contractual years-to-maturity (in millions):

	<u>Amortized Cost</u>	<u>Fair Value</u>
Due within one year	\$ 631.6	\$ 630.7
Due between one and three years	791.1	789.3
Total	<u>\$ 1,422.7</u>	<u>\$ 1,420.0</u>

#### **4. Derivative Instruments**

As a global business, we are exposed to currency exchange rate risk. Substantially all of our revenue is transacted in U.S. dollars, however, a portion of our operating expenditures are incurred outside of the United States and are denominated in foreign currencies, making them subject to fluctuations in foreign currency exchange rates. We enter into foreign currency derivative contracts with maturities of 12 months or less which we designate as cash flow hedges to manage the foreign currency exchange rate risk associated with these expenditures.

Beginning August 2016, we entered into forward contracts to hedge the foreign currency exchange rate risk arising from our foreign currency denominated expenditures to be incurred during the year ended July 31, 2017. All of these foreign currency forward contracts matured and were settled during the year ended July 31, 2017. Accordingly, we did not have any forward contracts outstanding as of July 31, 2017. During the year ended July 31, 2017, both unrealized losses recognized in AOCI related to the effective portion of our cash flow hedges and amounts reclassified into earnings were not material.

## 5. Acquisitions

### *Fiscal 2017*

#### *LightCyber Ltd.*

On February 27, 2017, we completed our acquisition of all outstanding shares of LightCyber Ltd. (“LightCyber”), a privately-held cybersecurity company, for total consideration of \$103.1 million in cash. The acquisition expands the functionality of our next-generation security platform with the addition of LightCyber’s behavioral analytics technology.

We have accounted for this transaction as a business combination and allocated the purchase consideration to assets acquired and liabilities assumed based on their preliminary estimated fair values, as presented in the following table (in millions):

	<u>Amount</u>
Cash	\$ 12.4
Goodwill	75.3
Identified intangible assets	19.5
Net liabilities assumed	<u>(4.1)</u>
Total	<u>\$ 103.1</u>

Additional information, such as that related to income tax and other contingencies, existing as of the acquisition date but unknown to us may become known during the remainder of the measurement period, not to exceed 12 months from the acquisition date, which may result in changes to the amounts and allocations recorded.

The following table presents details of the identified intangible assets acquired (in millions, except years):

	<u>Fair Value</u>	<u>Estimated Useful Life</u>
Developed technology	\$ 16.6	8 years
Customer relationships	<u>2.9</u>	8 years
Total	<u>\$ 19.5</u>	

Goodwill generated from this business combination is primarily attributable to the assembled workforce and expected synergies from integrating the LightCyber technology into our platform. The goodwill is not deductible for income tax purposes.

LightCyber’s operating results are included in our consolidated statements of operations from the date of acquisition. Pro forma results of operations have not been presented as the impact to our consolidated statements of operations is not material.

### *Fiscal 2015*

#### *CirroSecure, Inc.*

On May 22, 2015, we completed our acquisition of CirroSecure, Inc. (“CirroSecure”), a privately-held cybersecurity company. The acquisition expands the functionality of our next-generation security platform by providing additional security for SaaS applications. We accounted for this transaction as a business combination in exchange for total cash consideration of \$15.3 million.

We allocated the purchase consideration to the assets acquired and liabilities assumed based on their estimated fair values and as a result, recorded a developed technology intangible asset of \$11.0 million, goodwill of \$8.1 million, and net liabilities of \$3.8 million in our consolidated balance sheets as of the acquisition date. The developed technology is being amortized over an estimated useful life of seven years. The goodwill is attributable to the assembled workforce and expected post-acquisition synergies and is not deductible for income tax purposes.

## 6. Goodwill and Intangible Assets

### *Goodwill*

The following table presents details of our goodwill during the year ended July 31, 2017 (in millions):

	<u>Amount</u>
Balance as of July 31, 2016	\$ 163.5
Goodwill acquired	<u>75.3</u>
Balance as of July 31, 2017	<u>\$ 238.8</u>

Through July 31, 2017, we have not recognized any impairment losses on our goodwill.

### *Purchased Intangible Assets*

The following table presents details of our purchased intangible assets as of July 31, 2017 and July 31, 2016 (in millions):

	<u>July 31,</u>					
	<u>2017</u>			<u>2016</u>		
	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Net Carrying Amount</u>	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Net Carrying Amount</u>
Developed technology	\$ 69.7	\$ (23.8)	\$ 45.9	\$ 53.1	\$ (15.4)	\$ 37.7
Acquired intellectual property	8.9	(3.8)	5.1	8.9	(2.9)	6.0
Customer relationships	2.9	(0.2)	2.7	—	—	—
Other	2.4	(2.4)	—	2.4	(2.1)	0.3
Total purchased intangible assets	<u>\$ 83.9</u>	<u>\$ (30.2)</u>	<u>\$ 53.7</u>	<u>\$ 64.4</u>	<u>\$ (20.4)</u>	<u>\$ 44.0</u>

We recognized amortization expense of \$9.8 million, \$9.4 million, and \$7.9 million for the years ended July 31, 2017, 2016, and 2015, respectively.

The following table summarizes our estimated future amortization expense of intangible assets as of July 31, 2017 (in millions):

	<u>Amount</u>
Years ending July 31:	
2018	\$ 10.7
2019	10.6
2020	10.6
2021	8.9
2022	4.4
2023 and thereafter	<u>8.5</u>
Total future amortization expense	<u>\$ 53.7</u>

## 7. Property and Equipment

The following table presents details of our property and equipment, net as of July 31, 2017 and July 31, 2016 (in millions):

	July 31,	
	2017	2016
Computers, equipment, and software	\$ 156.6	\$ 102.7
Leasehold improvements	110.1	58.0
Demonstration units	26.3	20.1
Furniture and fixtures	20.4	14.6
Total property and equipment	313.4	195.4
Less: accumulated depreciation	(102.3)	(78.2)
Total property and equipment, net	\$ 211.1	\$ 117.2

We recognized depreciation expense of \$48.6 million, \$33.1 million, and \$20.3 million related to property and equipment during the years ended July 31, 2017, 2016, and 2015, respectively. During the year ended July 31, 2017, we impaired certain property and equipment related to the relocation of our corporate headquarters and recognized a loss of \$20.9 million in general and administrative expense on our consolidated statements of operations. Refer to Note 9. Commitments and Contingencies for more information.

## 8. Convertible Senior Notes

### *Convertible Senior Notes*

On June 30, 2014, we issued \$575.0 million aggregate principal amount of 0.0% Convertible Senior Notes due 2019 (the “Notes”). The Notes are governed by an indenture between us, as the issuer, and U.S. Bank National Association, as Trustee (the “Indenture”). The Notes are unsecured, unsubordinated obligations that 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. The Notes mature on July 1, 2019 unless converted or repurchased in accordance with their terms prior to such date. We cannot redeem the Notes prior to maturity.

The Notes are convertible for up to 5.2 million shares of our common stock at an initial conversion rate of approximately 9.068 shares of common stock per \$1,000 principal amount, which is equal to an initial conversion price of approximately \$110.28 per share of common stock, subject to adjustment. Holders of the Notes may surrender their Notes for conversion at their option at any time prior to the close of business on the business day immediately preceding January 1, 2019, only under the following circumstances:

- during any fiscal quarter commencing after the fiscal quarter ending on October 31, 2014 (and only during such fiscal quarter), if the last reported sale price of our common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter is greater than or equal to 130% of the conversion price for the Notes on each applicable trading day (the “sale price condition”);
- during the five business day period after any five consecutive trading day period, in which the trading price per \$1,000 principal amount of 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 for the Notes on each such trading day; or
- upon the occurrence of specified corporate events.

On or after January 1, 2019, holders may convert all or any portion of their 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, holders will receive cash equal to the aggregate principal amount of the

Notes to be converted, and, at our election, cash and/or shares of our common stock for any amounts in excess of the aggregate principal amount of the Notes being converted.

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” per the Indenture are, under certain circumstances, entitled to an increase in the conversion rate. Additionally, upon the occurrence of a corporate event that constitutes a “fundamental change” per the Indenture, holders of the Notes may require us to repurchase for cash all or a portion of the Notes at a purchase price equal to 100% of the principal amount of the Notes plus accrued and unpaid contingent interest.

The sale price condition was not met during the fiscal quarters ended July 31, 2017 and July 31, 2016. Since the Notes were not convertible, the net carrying amount of the Notes was classified as a long-term liability and the equity component was included in additional paid-in capital in our consolidated balance sheets as of July 31, 2017 and July 31, 2016.

The following table sets forth the components of the Notes as of July 31, 2017 and July 31, 2016 (in millions):

	July 31,	
	2017	2016
Liability:		
Principal	\$ 575.0	\$ 575.0
Less: debt discount and debt issuance costs, net of amortization	<u>50.3</u>	<u>74.8</u>
Net carrying amount	<u>\$ 524.7</u>	<u>\$ 500.2</u>
Equity	<u>\$ 109.8</u>	<u>\$ 109.8</u>

The total estimated fair value of the Notes was \$747.5 million and \$761.9 million at July 31, 2017 and July 31, 2016, respectively. The fair value was determined based on the closing trading price per \$100 of the Notes as of the last day of trading for the period. We consider the fair value of the Notes at July 31, 2017 and July 31, 2016 to be a Level 2 measurement. The fair value of the Notes is primarily affected by the trading price of our common stock and market interest rates. As of July 31, 2017, the if-converted value of the Notes exceeded its principal amount by \$137.7 million.

The following table sets forth interest expense recognized related to the Notes (dollars in millions):

	Year Ended July 31,		
	2017	2016	2015
Amortization of debt discount	\$ 22.0	\$ 21.1	\$ 20.2
Amortization of debt issuance costs	<u>2.5</u>	<u>2.3</u>	<u>2.1</u>
Total interest expense recognized	<u>\$ 24.5</u>	<u>\$ 23.4</u>	<u>\$ 22.3</u>
Effective interest rate of the liability component	<u>4.8%</u>	<u>4.8%</u>	<u>4.8%</u>

### **Note Hedges**

To minimize the impact of potential economic dilution upon conversion of the Notes, we entered into convertible note hedge transactions (the “Note Hedges”) with respect to our common stock concurrent with the issuance of the Notes. The Note Hedges cover up to 5.2 million shares of our common stock at a strike price per share that corresponds to the initial conversion price of the Notes, which are also subject to adjustment, and are exercisable upon conversion of the Notes. The Note Hedges will expire upon maturity of the Notes. The Note Hedges are separate transactions and are not part of the terms of the Notes. Holders of the Notes will not have

any rights with respect to the Note Hedges. The shares receivable related to the Note Hedges are excluded from the calculation of diluted earnings per share as they are antidilutive. We paid an aggregate amount of \$111.0 million for the Note Hedges, which is included in additional paid-in capital in our consolidated balance sheets.

### *Warrants*

Separately, but concurrently with our issuance of the Notes, we entered into transactions whereby we sold warrants (the “Warrants”) to acquire up to 5.2 million shares of our common stock at a strike price of approximately \$137.85 per share, subject to adjustments. The shares issuable under the Warrants will be included in the calculation of diluted earnings per share when the average market value per share of our common stock for the reporting period exceeds the strike price of the Warrants. The Warrants are separate transactions and are not part of the Notes or Note Hedges, and are not remeasured through earnings each reporting period. Holders of the Notes and Note Hedges will not have any rights with respect to the Warrants. We received aggregate proceeds of \$78.3 million from the sale of the Warrants, which is included in additional paid-in capital in our consolidated balance sheets.

## **9. Commitments and Contingencies**

### *Leases*

We lease our facilities under various non-cancelable operating leases, which expire through the year ending July 31, 2028.

In May 2015, we entered into two lease agreements for a total of approximately 631,000 square feet of corporate office space in Santa Clara, California, which serves as our new corporate headquarters. The leases commenced in August 2017 and expire in July 2028. In October 2015, we entered into a third lease agreement for approximately 310,000 square feet of additional office space, which is also part of our new corporate headquarters. This lease will commence in April 2018 and expires in July 2028. The leases contain a rent holiday period, scheduled rent increases, lease incentives, and renewal options which allow the lease terms to be extended through July 2046. Rental payments under the three lease agreements are approximately \$373.8 million over the lease term.

In May 2015, we also entered into a lease agreement for approximately 122,000 square feet of space in Santa Clara, California to serve as an extension of our previous corporate headquarters. The lease commenced in February 2016 and expires in April 2021. The lease contains scheduled rent increases, lease incentives, and renewal options which allow the lease term to be extended through July 2046. Rental payments under the lease agreement is approximately \$23.1 million over the lease term.

In September 2012, we entered into two lease agreements for a total of approximately 300,000 square feet of space in Santa Clara, California, which served as our previous corporate headquarters through August 2017, when we relocated to our new corporate campus. The leases commenced in November 2012 and August 2013, expire in July 2023, and allow for two separate five-year options to extend the lease term. Payments under these leases are approximately \$94.3 million over the lease term. Each lease has a rent holiday, which was included in the determination of rent expense.

In July 2013, we entered into a 51-month sub-lease agreement for our prior corporate headquarters with a commencement date of January 2014. Net proceeds from this sub-lease are approximately \$10.7 million over the lease term.

We recognized rent expense of \$35.9 million, \$20.2 million, and \$15.4 million for the years ended July 31, 2017, 2016, and 2015, respectively. Rent expense is recognized on a straight-line basis over the term of the lease.

The following table presents details of the aggregate future non-cancelable minimum rental payments under our operating leases as of July 31, 2017 (in millions):

	<u>Amount</u>
Years ending July 31:	
2018	\$ 31.0
2019	50.7
2020	60.1
2021	57.3
2022	53.9
2023 and thereafter	<u>264.5</u>
Committed gross lease payments	517.5
Less: proceeds from sublease rental	<u>2.1</u>
Net operating lease obligation	<u>\$ 515.4</u>

### ***Facility Exit Costs***

To support the growth of our business, in the fourth quarter of fiscal 2017, we committed to plans to relocate our corporate headquarters and sublet our previous headquarter facilities. In connection with the planned relocation, we determined, as of July 31, 2017, that certain leasehold improvements and other long-lived assets associated with our previous facilities were impaired and recognized a loss of \$20.9 million in general and administrative expense in our consolidated statements of operations during the year ended July 31, 2017. Refer to Note 2. Fair Value Measurements for more information on our impairment assessment.

We exited our previous headquarter facilities and relocated to our new corporate campus in August 2017. Refer to Note 18. Subsequent Events for more information.

### ***Manufacturing Purchase Commitments***

Our EMS provider procures components and assembles our products based on our forecasts. These forecasts are based on estimates of demand for our products primarily for the next 12 months, which are in turn based on historical trends and an analysis from our sales and product management organizations, adjusted for overall market conditions. In order to reduce manufacturing lead times and plan for adequate supply, we may issue non-cancelable orders for products and components to our manufacturing partners or component suppliers. As of July 31, 2017, our purchase commitments under such orders were \$104.1 million, of which \$5.6 million represent long-term purchase commitments through the year ending July 31, 2019, excluding obligations under contracts that we can cancel without a significant penalty.

### ***Litigation***

We are subject to legal proceedings, claims, and litigation arising in the ordinary course of business, including intellectual property litigation. Such matters are subject to many uncertainties and outcomes are not predictable with assurance. We accrue for contingencies when we believe that a loss is probable and that we can reasonably estimate the amount of any such loss.

To the extent there is a reasonable possibility that a loss exceeding amounts already recognized may be incurred and the amount of such additional loss would be material, we will either disclose the estimated additional loss or state that such an estimate cannot be made. As of July 31, 2017, we have not recorded any significant accruals for loss contingencies associated with such legal proceedings, determined that an unfavorable outcome is probable or reasonably possible, or determined that the amount or range of any possible loss is reasonably estimable.

### ***Indemnification***

Under the indemnification provisions of our standard sales related contracts, we agree to defend our end-customers against third-party claims asserting infringement of certain intellectual property rights, which may include patents, copyrights, trademarks, or trade secrets, and to pay judgments entered on such claims. Our exposure under these indemnification provisions is generally limited to payments made to us for the alleged infringing products over the preceding twelve months under the agreement. However, certain agreements include indemnification provisions that could potentially expose us to losses in excess of these payments. In addition, we indemnify our officers, directors, and certain key employees while they are serving in good faith in their company capacities. To date, we have not recorded any accruals for loss contingencies associated with indemnification claims or determined that an unfavorable outcome is probable or reasonably possible.

## **10. Stockholders' Equity**

### ***Share Repurchase***

On August 26, 2016, our board of directors authorized a \$500.0 million share repurchase which is funded from available working capital. On February 24, 2017, our board of directors authorized a \$500.0 million increase to our repurchase program, bringing the total authorization to \$1.0 billion. Repurchases may be made at management's discretion from time to time on the open market, through privately negotiated transactions, transactions structured through investment banking institutions, block purchase techniques, 10b5-1 trading plans, or a combination of the foregoing. The repurchase authorization will expire on December 31, 2018, and may be suspended or discontinued at any time.

During the year ended July 31, 2017, we repurchased and retired 3.3 million shares of our common stock under the authorization for an aggregate purchase price of \$420.1 million, including transaction costs. The total price of the shares repurchased and related transaction costs are reflected as a reduction to common stock and additional paid-in capital on our consolidated balance sheets. As of July, 31, 2017, \$580.0 million remained available for future share repurchases under the repurchase authorization.

## **11. Equity Award Plans**

### ***Share-Based Compensation Plans***

#### ***2012 Equity Incentive Plan***

Our 2012 Equity Incentive Plan (our "2012 Plan") was adopted by our board of directors and approved by the stockholders on June 5, 2012 and was effective one business day prior to the effectiveness of our registration statement for our initial public offering ("IPO"). Our 2012 Plan replaced our 2005 Equity Incentive Plan (our "2005 Plan"), which terminated upon the completion of our IPO, however, awards that were outstanding upon termination remained outstanding pursuant to their original terms. Our 2012 Plan provides for the granting of stock options, restricted stock awards ("RSAs"), restricted stock units ("RSUs"), stock appreciation rights, performance units, and performance shares ("PSAs") to our employees, directors, and consultants.

Awards granted under our 2012 Plan vest over the periods determined by the board of directors, generally three to four years from the date of grant, and our options expire no more than ten years after the date of grant. Since our IPO in 2012, awards granted under our 2012 Plan consist primarily of RSUs. Until vested, RSUs do not have the voting and dividend participation rights of common stock and the shares underlying the awards are not considered issued and outstanding.

In October 2016, we granted PSAs to certain employees, which will vest over a period of four years from the date of grant. The actual number of PSAs earned and eligible to vest is determined based on level of achievement against a pre-established billings target for the fiscal year ending July 31, 2017.

In February 2017, we began to net-share settle equity awards held by certain employees by withholding shares upon vesting to satisfy tax withholding obligations. The shares withheld to satisfy employee tax withholding obligations are returned to our 2012 Plan and will be available for future issuance. Payments for employees' tax obligations to the tax authorities are recognized as a reduction to additional paid-in capital and reflected as financing activities in our consolidated statements of cash flows.



A total of 16.9 million shares of our common stock are reserved for issuance pursuant to our 2012 Plan as of July 31, 2017. This includes shares that are (i) reserved but unissued under our 2005 Plan on the effective date of our 2012 Plan or (ii) returned to our 2005 Plan as a result of expiration or termination of options. On the first day of each fiscal year, the number of shares in the reserve may be increased by the lesser of (i) 8,000,000 shares, (ii) 4.5% of the outstanding shares of common stock on the last day of our immediately preceding fiscal year, or (iii) such other amount as determined by our board of directors.

#### *2012 Employee Stock Purchase Plan*

Our 2012 Employee Stock Purchase Plan (our “2012 ESPP”) was adopted by our board of directors and approved by the stockholders on June 5, 2012 and was effective upon completion of our IPO.

Our 2012 ESPP permits eligible employees to acquire shares of our common stock at 85% of the lower of the fair market value of our common stock on the first trading day of each offering period or on the exercise date. Each offering period will be approximately six months starting on the first trading date after March 15 and September 15 of each year. Participants may purchase shares of common stock through payroll deductions of up to 15% of their eligible compensation, subject to purchase limits of 625 shares during a six-month period or \$25,000 worth of stock for each calendar year. During the year ended July 31, 2017, employees purchased 0.4 million shares of common stock under our 2012 ESPP at an average exercise price of \$110.13 per share.

A total of 2.9 million shares of our common stock are available for sale under our 2012 ESPP as of July 31, 2017. On the first day of each fiscal year, the number of shares in the reserve may be increased by the lesser of (i) 2,000,000 shares, (ii) 1% of the outstanding shares of our common stock on the first day of the fiscal year, or (iii) such other amount as determined by our board of directors.

#### *Stock Option Activities*

The following table summarizes the stock option activity under our stock plans during the reporting period (in millions, except per share amounts):

	<u>Options Outstanding</u>			
	<u>Number of Shares</u>	<u>Weighted- Average Exercise Price Per Share</u>	<u>Weighted- Average Remaining Contractual Term (Years)</u>	<u>Aggregate Intrinsic Value</u>
Balance—July 31, 2016	2.1	\$ 13.42	5.2	\$ 244.9
Options granted	—	—		
Options forfeited	—	—		
Options exercised	<u>(0.5)</u>	14.44		
Balance—July 31, 2017	<u>1.6</u>	<u>\$ 13.11</u>	<u>4.2</u>	<u>\$ 190.6</u>
Options exercisable—July 31, 2017	<u>1.6</u>	<u>\$ 13.11</u>	<u>4.2</u>	<u>\$ 190.6</u>

The intrinsic value of options exercised during the years ended July 31, 2017, 2016, and 2015 was \$61.2 million, \$176.1 million, and \$301.1 million, respectively. The grant-date fair value of options vested during the years ended July 31, 2016 and 2015 was \$8.1 million and \$14.6 million, respectively. All options were fully vested as of July 31, 2016.

### *RSU, RSA, and PSA Activities*

The following table summarizes the RSU, RSA, and PSA activity under our stock plans during the reporting period (in millions, except per share amounts):

	<u>RSAs and PSAs Outstanding</u>		<u>RSUs Outstanding</u>			
	<u>Number of Shares</u>	<u>Weighted-Average Grant-Date Fair Value Per Share</u>	<u>Number of Shares</u>	<u>Weighted-Average Grant-Date Fair Value Per Share</u>	<u>Weighted-Average Remaining Contractual Term (Years)</u>	<u>Aggregate Intrinsic Value</u>
Balance—July 31, 2016	1.1	\$ 170.97	6.5	\$ 130.14	1.1	\$ 852.7
Granted <sup>(1)</sup>	0.3	148.54	3.9	141.35		
Vested	(0.4)	170.97	(3.3)	119.88		
Forfeited	—	—	(0.6)	139.56		
Balance—July 31, 2017	<u>1.0</u>	<u>\$ 163.55</u>	<u>6.5</u>	<u>\$ 141.16</u>	1.3	\$ 854.1

(1) The number of PSAs granted represents the aggregate maximum number of shares that may be earned and issued with respect to these awards over their full terms.

The weighted-average grant-date fair value of RSAs and PSAs granted during the years ended July 31, 2017 and 2016 was \$148.54 and \$170.97 per share, respectively. There were no RSAs or PSAs granted during the year ended July 31, 2015. The aggregate fair value, as of the respective vesting dates, of RSAs vested during the year ended July 31, 2017 was \$62.6 million. No RSAs vested during the years ended July 31, 2016 and 2015, and no PSAs vested during the three years ended July 31, 2017.

The weighted-average grant-date fair value of RSUs granted during the years ended July 31, 2017, 2016, and 2015 was \$141.35, \$160.60, and \$122.36 per share, respectively. The aggregate fair value, as of the respective vesting dates, of RSUs vested during the years ended July 31, 2017, 2016, and 2015 was \$462.6 million, \$513.0 million, and \$350.4 million, respectively.

### *Shares Available for Grant*

The following table presents the stock activity and the total number of shares available for grant under our stock plans as of July 31, 2017 (in millions):

	<u>Number of shares</u>
Balance—July 31, 2016	8.2
Authorized	4.1
RSUs, RSAs, and PSAs granted	(4.2)
RSUs and RSAs forfeited	0.6
Shares withheld for taxes	<u>0.1</u>
Balance—July 31, 2017	<u>8.8</u>

### *Share-Based Compensation*

We record share-based compensation awards based on estimated fair value as of the grant date. The fair value of RSUs, RSAs, and PSAs is based on the closing market price of our common stock on the date of grant. The fair value of shares sold through our 2012 ESPP are estimated on the grant date using the Black-Scholes option pricing model.

The following table summarizes share-based compensation included in costs and expenses (in millions):

	Year Ended July 31,		
	2017	2016	2015
Cost of product revenue	\$ 7.3	\$ 6.2	\$ 3.9
Cost of subscription and support revenue	56.2	40.9	20.4
Research and development	152.6	132.9	74.8
Sales and marketing	186.5	152.4	84.1
General and administrative	73.1	60.5	38.2
Total share-based compensation	<u>\$ 475.7</u>	<u>\$ 392.9</u>	<u>\$ 221.4</u>

At July 31, 2017, total compensation cost related to unvested share-based awards not yet recognized was \$906.8 million. This cost is expected to be amortized on a straight-line basis over a weighted-average period of approximately 2.6 years. Future grants will increase the amount of compensation expense to be recorded in these periods.

## 12. Income Taxes

The following table presents the components of income (loss) before income taxes (in millions):

	Year Ended July 31,		
	2017	2016 <sup>(1)</sup>	2015 <sup>(1)</sup>
United States	\$ (210.0)	\$ (195.3)	\$ (21.3)
Foreign	15.9	23.0	(100.6)
Total	<u>\$ (194.1)</u>	<u>\$ (172.3)</u>	<u>\$ (121.9)</u>

- (1) Certain amounts have been adjusted due to our voluntary change in accounting policy for sales commissions. Refer to Note 1. Description of Business and Summary of Significant Accounting Policies for more information.

The following table summarizes our provision for income taxes (in millions):

	Year Ended July 31,		
	2017	2016 <sup>(1)</sup>	2015
Federal:			
Current	\$ 3.4	\$ 1.9	\$ 1.8
Deferred	—	(0.6)	(3.0)
State:			
Current	0.9	1.1	0.7
Deferred	—	(0.1)	(0.4)
Foreign:			
Current	19.7	19.1	10.7
Deferred	(1.5)	(1.0)	(0.4)
Total	<u>\$ 22.5</u>	<u>\$ 20.4</u>	<u>\$ 9.4</u>

- (1) Certain amounts have been adjusted due to our voluntary change in accounting policy for sales commissions. Refer to Note 1. Description of Business and Summary of Significant Accounting Policies for more information.

For the year ended July 31, 2017, our provision for income taxes increased compared to the year ended July 31, 2016 primarily due to increases in foreign withholding taxes and U.S. income taxes related to inter-company transactions, offset by tax benefits from our adoption of new share-based payment accounting guidance in fiscal 2017. Refer to Note 1. Description of Business and Summary of Significant Accounting Policies for more information on our adoption of the accounting guidance.

For the year ended July 31, 2016, our provision for income taxes increased compared to the year ended July 31, 2015 primarily due to an increase in foreign taxes and amortization of our deferred tax charges.

The following table presents the items accounting for the difference between income taxes computed at the federal statutory income tax rate and our provision for income taxes:

	Year Ended July 31,		
	2017	2016 <sup>(1)</sup>	2015 <sup>(1)</sup>
Federal statutory rate	35.0%	35.0%	35.0%
Effect of:			
State taxes, net of federal tax benefit	2.8	(1.7)	4.6
Foreign income at other than U.S. rates	(14.4)	(7.8)	(6.1)
Change in valuation allowance	(39.4)	(25.4)	(28.8)
Share-based compensation	1.6	(15.9)	(13.0)
Amortization of deferred tax charges	(3.6)	(3.4)	(2.8)
Research credits	10.1	11.3	8.6
Other, net	(3.7)	(3.9)	(5.2)
Total	<u>(11.6)%</u>	<u>(11.8)%</u>	<u>(7.7)%</u>

- (1) Certain amounts have been adjusted due to our voluntary change in accounting policy for sales commissions. Refer to Note 1. Description of Business and Summary of Significant Accounting Policies for more information.

The change in foreign income at other than U.S. rates from the year ended July 31, 2016 to July 31, 2017 was due to current year intercompany transactions.

During the year ended July 31, 2017, we adopted new share-based payment accounting guidance that requires us to recognize excess tax benefits or deficiencies as income tax expense or benefit in the period in which they occur, rather than additional paid-in capital. The effect of the change from this guidance is reflected in the share-based compensation line above.

During the year ended July 31, 2016, we accounted for the outcome of *The Gillette Company et al. v. California Franchise Tax Board* which disallowed the election to use an evenly weighted, three factor apportionment formula utilized by us on our tax return for the year ended July 31, 2014. The impact for the change in apportionment is reflected in state taxes, net of federal tax benefit above and is fully offset by changes in our valuation allowance.

The following table presents the components of our deferred tax assets and liabilities as of July 31, 2017 and July 31, 2016 (in millions):

	July 31,	
	2017	2016 <sup>(1)</sup>
Deferred tax assets:		
Accruals and reserves	\$ 35.9	\$ 43.5
Deferred revenue	123.2	62.0
Net operating loss carryforwards	245.3	5.4
Research and development and foreign tax credits	69.3	41.4
Share-based compensation	45.4	55.2
Gross deferred tax assets	519.1	207.5
Valuation allowance	(464.1)	(161.3)
Total deferred tax assets	55.0	46.2
Deferred tax liabilities:		
Fixed assets and intangible assets	(9.1)	(14.2)
Deferred commissions	(36.8)	(27.7)
Other deferred tax liabilities	(4.0)	(2.5)
Total deferred tax liabilities	(49.9)	(44.4)
Total	\$ 5.1	\$ 1.8

- (1) Certain amounts have been adjusted due to our voluntary change in accounting policy for sales commissions. Refer to Note 1. Description of Business and Summary of Significant Accounting Policies for more information.

During the year ended July 31, 2017, we adopted new share-based payment accounting guidance related to the timing of when excess tax benefits are recognized. We adopted the guidance on a modified retrospective basis and, as a result, our deferred tax assets for the year ended July 31, 2017 reflect additional net operating losses of \$385.7 million and research and development credits of \$5.3 million that were not included in the balances for the year ended July 31, 2016. In addition, our valuation allowance increased \$389.2 million as a result of adopting the new guidance. The increase in net operating losses due to the adoption of the new guidance was partially offset by income in the U.S. due to intercompany transactions.

A valuation allowance is provided when it is more likely than not that the deferred tax asset will not be realized. Realization of deferred tax assets is dependent upon future taxable income, if any, the amount and timing of which are uncertain. At such time, if it is determined that it is more likely than not that the deferred tax assets are realizable, the valuation allowance will be adjusted. As of July 31, 2017, we have provided a valuation allowance for our federal, state, and certain foreign deferred tax assets that we believe will, more likely than not, be unrealizable. The net valuation allowance increased by approximately \$302.8 million from the year ended July 31, 2016 to the year ended July 31, 2017. The increase was primarily due to the adoption of new share-based payment accounting guidance and was partially offset by NOL utilization related to intercompany transactions.

As of July 31, 2017, we had federal, state, and foreign NOL carryforwards of approximately \$1.1 billion, \$806.4 million, and \$45.8 million, respectively, as reported on our tax returns, available to reduce future taxable income, if any. If not utilized, our federal and state NOL carryforwards will expire in various amounts at various dates beginning in the years ending July 31, 2027 and July 31, 2018, respectively. Our foreign NOL will carry forward indefinitely.

As of July 31, 2017, we had federal and state research and development tax credit carryforwards of approximately \$48.6 million and \$49.7 million, respectively as reported on our tax returns. If not utilized, the federal

credit carryforwards will expire in various amounts at various dates beginning in the year ending July 31, 2026. The state credit will carry forward indefinitely.

As of July 31, 2017, we had foreign tax credit carryforwards of \$2.5 million as reported on our tax returns. If not utilized, the foreign tax credit carryforwards will expire in various amounts at various dates beginning in the year ending July 31, 2021.

Utilization of the NOL carryforwards and credits may be subject to a substantial annual limitation due to the ownership change limitations provided by the Internal Revenue Code of 1986, as amended, and similar state provisions. The annual limitation may result in the expiration of NOLs and credits before utilization.

As a result of adopting the new share-based payment guidance, we did not reflect the impact of excess tax benefits in additional paid-in capital for the year ended July 31, 2017. Prior to adopting this guidance, we recorded excess tax benefits of \$0.5 million and \$2.5 million directly to additional paid-in capital for the years ended July 31, 2016 and 2015, respectively.

During the year ended July 31, 2017, we were awarded a tax incentive by a foreign jurisdiction. The incentive is effective through September 30, 2031, and is conditional upon meeting certain investment and employment thresholds. The impact of this incentive on our provision for income taxes was not material for the year ended July 31, 2017.

As of July 31, 2017, we had \$301.3 million of unrecognized tax benefits, \$34.0 million of which would affect income tax expense if recognized, after consideration of our valuation allowance in the United States and other assets. As of July 31, 2016, we had \$127.7 million of unrecognized tax benefits, \$21.9 million of which would affect income tax expense if recognized, after consideration of our valuation allowance in the United States. As of July 31, 2017, our federal, state, and foreign returns for the tax years 2008 through the current period remain subject to adjustment due to examination. Fiscal years outside the normal statute of limitation remain open to audit by tax authorities due to tax attributes generated in earlier years, which have been carried forward and may be audited in subsequent years when utilized. We do not expect the amount of unrecognized tax benefits as of July 31, 2017 to change significantly over the next 12 months. We recognize both interest and penalties associated with uncertain tax positions as a component of income tax expense. During the years ended July 31, 2017, 2016, and 2015, we recognized income tax expense related to interest and penalties of \$2.1 million, \$1.6 million, and \$1.1 million, respectively. We had accrued interest and penalties on our consolidated balance sheets related to unrecognized tax benefits of \$5.4 million and \$3.3 million as of July 31, 2017 and 2016, respectively. The ultimate amount and timing of any future cash settlements cannot be predicted with reasonable certainty.

The following table presents a reconciliation of the beginning and ending amount of our gross unrecognized tax benefits (in millions):

	Year Ended July 31,		
	2017	2016	2015
Unrecognized tax benefits at the beginning of the period	\$ 127.7	\$ 67.2	\$ 10.4
Additions for tax positions taken in prior years	3.1	25.2	6.1
Reductions for tax positions taken in prior years	—	—	(0.6)
Additions for tax positions taken in the current year	<u>170.5</u>	<u>35.3</u>	<u>51.3</u>
Unrecognized tax benefits at the end of the period	<u>\$ 301.3</u>	<u>\$ 127.7</u>	<u>\$ 67.2</u>

During the year ended July 31, 2017, our additions for tax positions taken in the current year were primarily attributable to uncertainties related to intercompany transactions.

During the year ended July 31, 2016, our additions for tax positions taken in prior years and additions for tax positions taken in the current year were primarily attributable to uncertain tax positions relating to federal and state research and development credits, adjustments for California apportionment, and transfer pricing methodologies.

As of July 31, 2017, we had no unremitted earnings when evaluating our outside basis differences relating to our investment in foreign subsidiaries. Accordingly, we have not provided a deferred tax liability for any potential U.S. income taxes or foreign withholding taxes.

### 13. Net Loss Per Share

Basic net loss per share is computed by dividing net loss by basic weighted-average shares outstanding during the period. Diluted net loss per share is computed by dividing net loss by diluted weighted-average shares outstanding, including potentially dilutive securities.

The following table presents the computation of basic and diluted net loss per share of common stock (in millions, except per share data):

	Year Ended July 31,		
	2017	2016	2015
Net loss	\$ (216.6)	\$ (192.7)	\$ (131.3)
Weighted-average shares used to compute net loss per share, basic and diluted	90.6	87.1	81.6
Net loss per share, basic and diluted	\$ (2.39)	\$ (2.21)	\$ (1.61)

The following securities were excluded from the computation of diluted net loss per share of common stock for the periods presented as their effect would have been antidilutive (in millions):

	Year Ended July 31,		
	2017	2016	2015
RSUs	6.5	6.5	7.2
Convertible senior notes	5.2	5.2	5.2
Warrants related to the issuance of convertible senior notes	5.2	5.2	5.2
Options to purchase common stock	1.6	2.1	3.3
RSAs and PSAs	1.0	1.1	—
ESPP shares	0.2	0.1	0.1
Total	19.7	20.2	21.0

### 14. Other Income, Net

The following table sets forth the components of other income, net (in millions):

	Year Ended July 31,		
	2017	2016	2015
Interest income	\$ 14.7	\$ 8.8	\$ 3.9
Foreign currency exchange losses, net	(3.4)	—	(3.0)
Other	(1.1)	(0.4)	(0.7)
Total other income, net	\$ 10.2	\$ 8.4	\$ 0.2

## 15. Employee Benefit Plan

We have established a 401(k) tax-deferred savings plan which permits participants to make contributions by salary deduction pursuant to Section 401(k) of the Internal Revenue Code. In fiscal 2016, we began to make matching contributions based upon the amount of employees' contributions, subject to certain limitations. Our matching contributions to the plan were immaterial for the years ended July 31, 2017 and 2016.

## 16. Segment Information

We conduct business globally and are primarily managed on a geographic theater basis. Our chief operating decision maker reviews financial information presented on a consolidated basis accompanied by information about revenue by geographic region for purposes of allocating resources and evaluating financial performance. We have one business activity and there are no segment managers who are held accountable for operations, operating results, and plans for levels, components, or types of products or services below the consolidated unit level. Accordingly, we are considered to be in a single reportable segment and operating unit structure.

The following table presents revenue by geographic theater (in millions):

	Year Ended July 31,		
	2017	2016	2015
Revenue:			
Americas			
United States	\$ 1,155.3	\$ 901.8	\$ 593.8
Other Americas	82.1	71.4	45.6
Total Americas	1,237.4	973.2	639.4
Europe, the Middle East, and Africa ("EMEA")	320.1	247.1	178.7
Asia Pacific and Japan ("APAC")	204.1	158.2	110.0
Total revenue	<u>\$ 1,761.6</u>	<u>\$ 1,378.5</u>	<u>\$ 928.1</u>

The following table presents revenue for groups of similar products and services (in millions):

	Year Ended July 31,		
	2017	2016	2015
Revenue:			
Product	\$ 709.1	\$ 670.8	\$ 492.7
Subscription and support			
Subscription	550.8	357.0	212.7
Support	501.7	350.7	222.7
Total subscription and support	1,052.5	707.7	435.4
Total revenue	<u>\$ 1,761.6</u>	<u>\$ 1,378.5</u>	<u>\$ 928.1</u>

The following table presents our property and equipment, net by geographic region (in millions):

	Year Ended July 31,	
	2017	2016
Property and equipment, net:		
United States	\$ 178.4	\$ 102.3
International	32.7	14.9
Total property and equipment, net	<u>\$ 211.1</u>	<u>\$ 117.2</u>



## 17. Selected Quarterly Financial Data (Unaudited)

The following tables set forth selected unaudited quarterly financial data for the years ended July 31, 2017 and 2016 (in millions, except per share amounts):

	Three Months Ended			
	Oct. 31, 2016 <sup>(1)</sup>	Jan. 31, 2017	Apr. 30, 2017	Jul. 31, 2017
Revenue:				
Product	\$ 163.8	\$ 168.8	\$ 164.2	\$ 212.3
Subscription and support	234.3	253.8	267.6	296.8
Total revenue	398.1	422.6	431.8	509.1
Cost of revenue:				
Product	42.2	45.8	49.7	63.7
Subscription and support	59.0	67.4	74.0	74.8
Total cost of revenue	101.2	113.2	123.7	138.5
Total gross profit	296.9	309.4	308.1	370.6
Operating expenses:				
Research and development	84.2	89.9	86.0	87.3
Sales and marketing	220.1	226.7	226.9	245.4
General and administrative	41.6	47.2	44.3	65.2
Total operating expenses	345.9	363.8	357.2	397.9
Operating loss	(49.0)	(54.4)	(49.1)	(27.3)
Interest expense	(6.0)	(6.1)	(6.2)	(6.2)
Other income, net	2.5	2.7	2.1	2.9
Loss before income taxes	(52.5)	(57.8)	(53.2)	(30.6)
Provision for income taxes	4.4	2.8	7.7	7.6
Net loss	<u>\$ (56.9)</u>	<u>\$ (60.6)</u>	<u>\$ (60.9)</u>	<u>\$ (38.2)</u>
Net loss per share, basic and diluted	<u>\$ (0.63)</u>	<u>\$ (0.67)</u>	<u>\$ (0.67)</u>	<u>\$ (0.42)</u>

- (1) Certain amounts have been adjusted due to our early adoption of new share-based payment accounting guidance. Refer to Note 1. Description of Business and Summary of Significant Accounting Policies for more information.

	Three Months Ended			
	Oct. 31, 2015	Jan. 31, 2016	Apr. 30, 2016	Jul. 31, 2016
Revenue:				
Product	\$ 147.7	\$ 169.9	\$ 162.1	\$ 191.1
Subscription and support	149.5	164.8	183.7	209.7
Total revenue	<u>297.2</u>	<u>334.7</u>	<u>345.8</u>	<u>400.8</u>
Cost of revenue:				
Product	38.8	44.9	43.2	48.5
Subscription and support	40.4	49.3	51.7	53.2
Total cost of revenue	<u>79.2</u>	<u>94.2</u>	<u>94.9</u>	<u>101.7</u>
Total gross profit	218.0	240.5	250.9	299.1
Operating expenses:				
Research and development	59.7	74.0	74.0	76.5
Sales and marketing <sup>(1)</sup>	159.5	182.4	195.9	205.4
General and administrative	30.8	34.2	33.5	39.9
Total operating expenses <sup>(1)</sup>	<u>250.0</u>	<u>290.6</u>	<u>303.4</u>	<u>321.8</u>
Operating loss <sup>(1)</sup>	(32.0)	(50.1)	(52.5)	(22.7)
Interest expense	(5.8)	(5.8)	(5.8)	(6.0)
Other income, net	2.2	2.5	1.0	2.7
Loss before income taxes <sup>(1)</sup>	(35.6)	(53.4)	(57.3)	(26.0)
Provision for income taxes <sup>(1)</sup>	4.3	3.9	6.8	5.4
Net loss <sup>(1)</sup>	<u>\$ (39.9)</u>	<u>\$ (57.3)</u>	<u>\$ (64.1)</u>	<u>\$ (31.4)</u>
Net loss per share, basic and diluted <sup>(1)</sup>	<u>\$ (0.47)</u>	<u>\$ (0.66)</u>	<u>\$ (0.73)</u>	<u>\$ (0.35)</u>

(1) Amounts have been adjusted due to our voluntary change in accounting policy for sales commissions. Refer to Note 1. Description of Business and Summary of Significant Accounting Policies for more information.

## 18. Subsequent Events

### *Facility Exit*

In August 2017, we exited our previous headquarter facilities and relocated to our new corporate campus. As a result, we expect to recognize a cease-use loss of approximately \$15.4 million during the first quarter of fiscal 2018. The cease-use loss is calculated based on the remaining lease obligation for the vacated facilities, adjusted for the effects of any deferred items recognized under the leases, estimated sublease rentals that could be reasonably obtained, and related costs. The amount of the cease-use loss may vary if the timing or amount of estimated cash flows change. Refer to Note 9. Commitments and Contingencies for more information on the relocation of our corporate headquarters.

## **ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

## **ITEM 9A. CONTROLS AND PROCEDURES**

### ***Evaluation of Disclosure Controls and Procedures***

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Based on our evaluation, our chief executive officer and chief financial officer concluded that, as of July 31, 2017, our disclosure controls and procedures are designed at a reasonable assurance level and are effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission (SEC) rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

### ***Management’s Annual Report on Internal Control Over Financial Reporting***

For “Management’s Annual Report on Internal Control Over Financial Reporting” see the report under Part II, Item 8 of this Annual Report on Form 10-K, which report is incorporated herein by reference.

For the “Report of Independent Registered Public Accounting Firm,” see the report under Part II, Item 8 of this Annual Report on Form 10-K, which report is incorporated herein by reference.

### ***Changes in Internal Control Over Financial Reporting***

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

## **ITEM 9B. OTHER INFORMATION**

None.

### **PART III**

#### **ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

##### **Executive Officers and Directors**

The information required by this item will be contained in our definitive proxy statement to be filed with the SEC in connection with our 2017 annual meeting of stockholders (the "Proxy Statement"), which is expected to be filed not later than 120 days after the end of our fiscal year ended July 31, 2017, and is incorporated in this report by reference.

#### **ITEM 11. EXECUTIVE COMPENSATION**

The information required by this item will be set forth in the Proxy Statement and is incorporated herein by reference.

#### **ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information required by this item will be set forth in the Proxy Statement and is incorporated herein by reference.

#### **ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

The information required by this item will be set forth in the Proxy Statement and is incorporated herein by reference.

#### **ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information required by this item will be set forth in the Proxy Statement and is incorporated herein by reference.

## PART IV

### ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

Documents filed as part of this Annual Report on Form 10-K are as follows:

1. Consolidated Financial Statements

Our Consolidated Financial Statements are listed in the “Index to Consolidated Financial Statements” under Part II, Item 8 of this Annual Report on Form 10-K.

2. Financial Statement Schedules

Financial statement schedules have been omitted because they are not required, not applicable, not present in amounts sufficient to require submission of the schedule, or the required information is shown in the Consolidated Financial Statements or Notes thereto.

3. Exhibits

The documents listed in the Exhibit Index of this Annual Report on Form 10-K are incorporated by reference or are filed with this Annual Report on Form 10-K, in each case as indicated therein (numbered in accordance with Item 601 of Regulation S-K).

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on September 7, 2017.

**PALO ALTO NETWORKS, INC.**

By: /s/ MARK D. McLAUGHLIN

Mark D. McLaughlin  
*Chief Executive Officer*

## POWER OF ATTORNEY

KNOW ALL THESE PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Mark D. McLaughlin and Steffan C. Tomlinson, and each of them, as his true and lawful attorney-in-fact and agent, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or any of them, or their or his substitutes, may lawfully do or cause to be done by virtue thereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated:

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ MARK D. McLAUGHLIN</u> Mark D. McLaughlin	Chief Executive Officer and Director (Principal Executive Officer)	September 7, 2017
<u>/s/ STEFFAN C. TOMLINSON</u> Steffan C. Tomlinson	Chief Financial Officer (Principal Accounting and Financial Officer)	September 7, 2017
<u>/s/ NIR ZUK</u> Nir Zuk	Chief Technical Officer and Director	September 7, 2017
<u>/s/ FRANK CALDERONI</u> Frank Calderoni	Director	September 7, 2017
<u>/s/ ASHEEM CHANDNA</u> Asheem Chandna	Director	September 7, 2017
<u>/s/ JOHN M. DONOVAN</u> John M. Donovan	Director	September 7, 2017
<u>/s/ CARL ESCHENBACH</u> Carl Eschenbach	Director	September 7, 2017
<u>/s/ JAMES J. GOETZ</u> James J. Goetz	Director	September 7, 2017
<u>/s/ MARY PAT MCCARTHY</u> Mary Pat McCarthy	Director	September 7, 2017
<u>/s/ STANLEY J. MERESMAN</u> Stanley J. Meresman	Director	September 7, 2017
<u>/s/ SRIDHAR RAMASWAMY</u> Sridhar Ramaswamy	Director	September 7, 2017
<u>/s/ DANIEL J. WARMENHOVEN</u> Daniel J. Warmenhoven	Director	September 7, 2017

## EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference			
		Form	File No.	Exhibit	Filing Date
3.1	Restated Certificate of Incorporation of the Registrant.	10-K	001-35594	3.1	October 4, 2012
3.2	Amended and Restated Bylaws of the Registrant.	10-K	001-35594	3.2	October 4, 2012
3.3	Certificate of Change of Location of Registered Agent and/or Registered Office.	8-K	001-35594	3.1	August 30, 2016
4.1	Warrant to Purchase Stock by Juniper Networks, Inc.	8-K	001-35594	4.1	June 4, 2014
4.2	Indenture between the Registrant and U.S. Bank National Association, dated as of June 30, 2014.	8-K	001-35594	4.1	July 1, 2014
10.1*	Form of Indemnification Agreement between the Registrant and its directors and officers.	S-1/A	333-180620	10.1	July 9, 2012
10.2*	2005 Equity Incentive Plan and related form agreements under 2005 Equity Incentive Plan.	S-1/A	333-180620	10.2	July 9, 2012
10.3*	2012 Equity Incentive Plan and related form agreements under 2012 Equity Incentive Plan, as amended.	10-K	001-35594	10.3	September 18, 2014
10.4*	2012 Employee Stock Purchase Plan and related form agreements under 2012 Employee Stock Purchase Plan, as amended and restated.				
10.5*	Employee Incentive Compensation Plan, as amended and restated.	10-Q	001-35594	10.2	November 25, 2014
10.6*	Offer Letter between the Registrant and Mark D. McLaughlin, dated July 21, 2011, as amended.	S-1	333-180620	10.6	April 6, 2012
10.7*	Offer Letter between the Registrant and Steffan C. Tomlinson, dated January 17, 2012.	S-1	333-180620	10.7	April 6, 2012
10.8*	Letter Agreement between the Registrant and Nir Zuk, dated December 19, 2011.	S-1	333-180620	10.8	April 6, 2012
10.9*	Letter Agreement between the Registrant and René Bonvanie, dated December 19, 2011.	S-1	333-180620	10.10	April 6, 2012
10.10*	Offer Letter between the Registrant and Stanley J. Meresman, dated September 8, 2014.	8-K	001-35594	10.1	September 22, 2014



Exhibit Number	Exhibit Description	Incorporated by Reference			
		Form	File No.	Exhibit	Filing Date
10.11*	Offer Letter between the Registrant and Daniel J. Warmenhoven, dated February 14, 2012.	S-1	333-180620	10.13	April 6, 2012
10.12*	Offer Letter between the Registrant and Mark F. Anderson, dated May 23, 2012.	S-1/A	333-180620	10.16	July 9, 2012
10.13*	Offer Letter between the Registrant and John M. Donovan, dated September 14, 2012.	8-K	001-35594	10.1	September 20, 2012
10.14*	Offer Letter between the Registrant and Carl Eschenbach, dated May 9, 2013.	8-K	001-35594	10.1	May 30, 2013
10.15*	Offer Letter between the Registrant and Frank Calderoni, dated February 24, 2016.	8-K	001-35594	10.1	February 25, 2016
10.16*	Offer Letter between the Registrant and Mary Pat McCarthy, dated October 13, 2016.	8-K	001-35594	10.1	October 24, 2016
10.17	Lease between the Registrant and Santa Clara Office Partners LLC, dated October 20, 2010, as amended.	S-1	333-180620	10.14	April 6, 2012
10.18	Amendment No. 2 to Lease between the Registrant and Santa Clara Office Partners LLC, dated July 2, 2013.	10-K	001-35594	10.17	September 25, 2013
10.19	Lease between the Registrant and SI 34 LLC, dated September 17, 2012.	10-K	001-35594	10.16	October 4, 2012
10.20	Lease between the Registrant and SI 34 LLC, dated September 17, 2012.	10-K	001-35594	10.17	October 4, 2012
10.21**	Amended and Restated Flextronics Manufacturing Services Agreement, by and between the Registrant and Flextronics Telecom Systems Ltd., dated December 8, 2015.	8-K	001-35594	10.1	December 14, 2015
10.22	Settlement, Release and Cross-License Agreement, dated May 27, 2014, by and between the Registrant and Juniper Networks, Inc.	8-K	001-35594	10.1	May 28, 2014
10.23	Share Purchase Agreement between the Registrant, Cyvera Ltd., Palo Alto Networks Holding B.V., the shareholders of Cyvera Ltd. and Shareholder Representative Services LLC, dated March 22, 2014.	10-Q	001-35594	10.1	June 3, 2014
10.24	Amendment No. 1 to the Share Purchase Agreement between the Registrant, Cyvera Ltd., Palo Alto Networks Holding B.V., the shareholders of Cyvera Ltd. and Shareholder Representative Services LLC, dated April 9, 2014.	10-Q	001-35594	10.2	June 3, 2014

Exhibit Number	Exhibit Description	Incorporated by Reference			
		Form	File No.	Exhibit	Filing Date
10.25	Purchase Agreement, dated June 24, 2014, by and among the Registrant and J.P. Morgan Securities LLC, RBC Capital Markets, LLC and Citigroup Global Markets Inc., as representatives of the initial purchasers named therein.	8-K	001-35594	10.1	June 26, 2014
10.26	Form of Convertible Note Hedge Confirmation.	8-K	001-35594	10.2	June 26, 2014
10.27	Form of Warrant Confirmation.	8-K	001-35594	10.3	June 26, 2014
10.28	Lease between the Registrant and Santa Clara Campus Property Owner I LLC, dated May 28, 2015.	10-K	001-35594	10.29	September 17, 2015
10.29	Lease between the Registrant and Santa Clara Campus Property Owner I LLC, dated May 28, 2015.	10-K	001-35594	10.30	September 17, 2015
10.30	Lease between the Registrant and Santa Clara Campus Property Owner I LLC, dated May 28, 2015.	10-K	001-35594	10.31	September 17, 2015
10.31	Lease by and between the Registrant and Santa Clara Campus Property Owner I LLC, dated October 7, 2015.	8-K	001-35594	10.1	October 19, 2015
10.32	Amendment No. 1 to Lease by and between the Registrant and Santa Clara Phase I Property LLC, dated November 9, 2015.	10-Q	001-35594	10.2	November 24, 2015
10.33	Amendment No. 1 to Lease by and between the Registrant and Santa Clara Campus Property Owner I LLC, dated November 9, 2015.	10-Q	001-35594	10.3	November 24, 2015
10.34	Amendment No. 1 to Lease by and between the Registrant and Santa Clara Campus Property Owner I LLC, dated September 16, 2016.	10-Q	001-35594	10.1	November 22, 2016
10.35	Amendment No. 1 to Lease by and between the Registrant and Santa Clara Campus Property Owner I LLC, dated September 16, 2016.	10-Q	001-35594	10.2	November 22, 2016
10.36	Amendment No. 2 to Lease by and between the Registrant and Santa Clara Campus Property Owner I LLC, dated September 16, 2016.	10-Q	001-35594	10.3	November 22, 2016
10.37	Amendment No. 2 to Lease by and between the Registrant and Santa Clara Campus Property Owner I LLC, dated November 16, 2016.	10-Q	001-35594	10.1	March 1, 2017

Exhibit Number	Exhibit Description	Incorporated by Reference			
		Form	File No.	Exhibit	Filing Date
10.38	Amendment No. 2 to Lease by and between the Registrant and Santa Clara Campus Property Owner I LLC, dated November 16, 2016.	10-Q	001-35594	10.2	March 1, 2017
10.39	Amendment No. 3 to Lease by and between the Registrant and Santa Clara Campus Property Owner I LLC, dated November 16, 2016.	10-Q	001-35594	10.3	March 1, 2017
10.40	Amendment No. 3 to Lease by and between the Registrant and Santa Clara EFH LLC, dated June 22, 2017.				
10.41	Amendment No. 3 to Lease by and between the Registrant and Santa Clara G LLC, dated June 22, 2017.				
10.42	Amendment No. 4 to Lease by and between the Registrant and Santa Clara EFH LLC, dated June 22, 2017.				
21.1	List of subsidiaries of the Registrant.				
23.1	Consent of Independent Registered Public Accounting Firm.				
24.1	Power of Attorney (contained in the signature page to this Annual Report on Form 10-K).				
31.1	Certification of the Chief Executive Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.				
31.2	Certification of the Chief Financial Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.				
32.1†	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.				
32.2†	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.				
101.INS	XBRL Instance Document.				
101.SCH	XBRL Taxonomy Schema Linkbase Document.				
101.CAL	XBRL Taxonomy Calculation Linkbase Document.				

Exhibit Number	Exhibit Description	Incorporated by Reference			
		Form	File No.	Exhibit	Filing Date
101.DEF	XBRL Taxonomy Definition Linkbase Document.				
101.LAB	XBRL Taxonomy Labels Linkbase Document.				
101.PRE	XBRL Taxonomy Presentation Linkbase Document.				
*	Indicates a management contract or compensatory plan or arrangement.				
**	Registrant has omitted portions of the relevant exhibit and filed such exhibit separately with the Securities and Exchange Commission pursuant to a request for confidential treatment under Rule 406 under the Securities Act of 1933, as amended.				
†	The certifications attached as Exhibit 32.1 and Exhibit 32.2 that accompany this Annual Report on Form 10-K, are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference into any filing of the Registrant under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Annual Report on Form 10-K, irrespective of any general incorporation language contained in such filing.				

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## BOARD OF DIRECTORS

### Mark D. McLaughlin

Chief Executive Officer and Chairman of the Board of Directors

### Nir Zuk

Chief Technology Officer and Director

### Frank Calderoni

President and Chief Executive Officer, Anaplan, Inc.

### Asheem Chandna

Partner, Greylock Partners

### John M. Donovan

Chief Executive Officer—AT&T Communications

### Carl Eschenbach

General Partner, Sequoia Capital Operations, LLC

### James J. Goetz

Managing Member, Sequoia Capital

### Mary Pat McCarthy

Former Vice Chair, KPMG LLP

### Stanley J. Meresman

Former Venture Partner, Technology Crossover Ventures

### Sridhar Ramaswamy

Senior Vice President, Ads & Commerce, Google, Inc.

### Daniel J. Warmenhoven

Former Executive Chairman, NetApp, Inc.

## CORPORATE EXECUTIVES

### Mark D. McLaughlin

Chief Executive Officer and Chairman of the Board of Directors

### Steffan C. Tomlinson

Chief Financial Officer

### Nir Zuk

Chief Technology Officer and Director

### René Bonvanie

Chief Marketing Officer

### Mark F. Anderson

President

### Lee Klarich

Chief Product Officer

**FORWARD-LOOKING STATEMENTS:** This Annual Report (including the Stockholder Letter) contains forward-looking statements within meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. All statements in this Annual Report other than statements of historical fact are statements that could be deemed to be forward-looking statements, including but not limited to statements that refer to the timing of new product offerings, the expected efficacy of our products and subscription and support offerings, continued growth opportunity, and any statements or assumptions underlying any of the foregoing. These statements are

## CORPORATE HEADQUARTERS

Palo Alto Networks, Inc.

3000 Tannery Way  
Santa Clara, California 95054

T: (408) 753-4000

F: (408) 753-4001

[www.paloaltonetworks.com](http://www.paloaltonetworks.com)

## COMMON STOCK LISTING

New York Stock Exchange

Ticker Symbol: PANW

## ANNUAL MEETING OF STOCKHOLDERS

Friday, December 8, 2017, at 10:00 a.m.

Palo Alto Networks, Inc.

3000 Tannery Way  
Santa Clara, CA 95054

## REGISTRAR AND TRANSFER AGENT

For questions regarding your account, changes of address or the consolidation of accounts, please contact the Company's transfer agent:

Computershare Trust Company, N.A.

250 Royall Street

Canton, Massachusetts 02021

T: (877) 373-6374

Foreign Stockholders: (781) 575-2879

[www.computershare.com/investor](http://www.computershare.com/investor)

## LEGAL COUNSEL

Wilson Sonsini Goodrich & Rosati

Professional Corporation

Palo Alto, California

## INDEPENDENT AUDITORS

Ernst & Young LLP

San Francisco, California

## INVESTOR RELATIONS

Palo Alto Networks, Inc.

Investor Relations

3000 Tannery Way

Santa Clara, California 95054

E: [ir@paloaltonetworks.com](mailto:ir@paloaltonetworks.com)

T: (415) 217-7722

## CALCULATION OF BILLINGS (in millions):

Total revenue	\$ 1,761.6
Add: change in total deferred revenue, net of acquired deferred revenue	531.8
Billings	\$ 2,293.4

only predictions, based on our current expectations about future events and may not prove to be accurate. We do not undertake any obligation to update these forward-looking statements to reflect events occurring or circumstances arising after the date of this report. These forward-looking statements involve risks and uncertainties, and our actual results, performance, or achievements could differ materially from those expressed or implied by the forward-looking statements on the basis of several factors, including those that we discuss in the "Risk Factors" section and throughout our most recent Annual Report on Form 10-K, which is included in this Annual Report.

