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

FORM 10-Q

(Mark One)

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

For the quarterly period ended January 31, 2018

or

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

For the transition period from to

Commission File Number 001-35594

PALO ALTO NETWORKS, INC.
(Exact name of registrant as specified in its charter)

Delaware	**20-2530195**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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	☒	Accelerated filer	☐
Non-accelerated filer	☐ (Do not check if a smaller reporting company)	Smaller reporting company	☐
		Emerging growth company	☐

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

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

The number of shares outstanding of the registrant's common stock as of February 15, 2018 was 91,848,283.

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PART I

ITEM 1. FINANCIAL STATEMENTS

PALO ALTO NETWORKS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited, in millions, except per share data)

	January 31, 2018	July 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$ 915.0	$ 744.3
Short-term investments	720.7	630.7
Accounts receivable, net of allowance for doubtful accounts of $1.0 and $0.7 at January 31, 2018 and July 31, 2017, respectively	365.1	432.1
Prepaid expenses and other current assets	209.4	169.2
Total current assets	2,210.2	1,976.3
Property and equipment, net	264.7	211.1
Long-term investments	722.3	789.3
Goodwill	238.8	238.8
Intangible assets, net	48.3	53.7
Other assets	143.2	169.1
Total assets	$ 3,627.5	$ 3,438.3
Liabilities, temporary equity, and stockholders' equity		
Current liabilities:		
Accounts payable	$ 33.4	$ 35.5
Accrued compensation	113.2	117.5
Accrued and other liabilities	83.6	79.9
Deferred revenue	1,088.8	968.4
Convertible senior notes, net	537.4	—
Total current liabilities	1,856.4	1,201.3
Convertible senior notes, net	—	524.7
Long-term deferred revenue	907.9	805.1
Other long-term liabilities	196.6	147.6
Commitments and contingencies (Note 6)		
Temporary equity	33.5	—
Stockholders' equity:		
Preferred stock; $0.0001 par value; 100.0 shares authorized; none issued and outstanding at January 31, 2018 and July 31, 2017	—	—
Common stock and additional paid-in capital; $0.0001 par value; 1,000.0 shares authorized; 91.8 and 91.5 shares issued and outstanding at January 31, 2018 and July 31, 2017, respectively	1,575.9	1,599.7
Accumulated other comprehensive loss	(7.2)	(3.4)
Accumulated deficit	(935.6)	(836.7)
Total stockholders' equity	633.1	759.6
Total liabilities, temporary equity, and stockholders' equity	$ 3,627.5	$ 3,438.3

See notes to condensed consolidated financial statements.

PALO ALTO NETWORKS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited, in millions, except per share data)

	Three Months Ended January 31,		Six Months Ended January 31,	
	2018	2017	2018	2017
Revenue:				
Product	$ 202.2	$ 168.8	$ 388.7	$ 332.6
Subscription and support	340.2	253.8	659.2	488.1
Total revenue	542.4	422.6	1,047.9	820.7
Cost of revenue:				
Product	63.9	45.8	121.5	88.0
Subscription and support	95.4	67.4	179.2	126.4
Total cost of revenue	159.3	113.2	300.7	214.4
Total gross profit	383.1	309.4	747.2	606.3
Operating expenses:				
Research and development	96.6	89.9	190.8	174.1
Sales and marketing	265.0	226.7	523.5	446.8
General and administrative	53.3	47.2	119.0	88.8
Total operating expenses	414.9	363.8	833.3	709.7
Operating loss	(31.8)	(54.4)	(86.1)	(103.4)
Interest expense	(6.4)	(6.1)	(12.7)	(12.1)
Other income, net	4.9	2.7	9.7	5.2
Loss before income taxes	(33.3)	(57.8)	(89.1)	(110.3)
Provision for income taxes	1.6	2.8	9.8	7.2
Net loss	$ (34.9)	$ (60.6)	$ (98.9)	$ (117.5)
Net loss per share, basic and diluted	$ (0.38)	$ (0.67)	$ (1.09)	$ (1.30)
Weighted-average shares used to compute net loss per share, basic and diluted	91.1	90.7	91.0	90.2

See notes to condensed consolidated financial statements.

PALO ALTO NETWORKS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(Unaudited, in millions)

	Three Months Ended January 31,		Six Months Ended January 31,	
	2018	2017	2018	2017
Net loss	$ (34.9)	$ (60.6)	$ (98.9)	$ (117.5)
Other comprehensive loss, net of tax:				
Change in unrealized gains (losses) on investments	(5.3)	(2.9)	(7.2)	(4.7)
Change in unrealized gains (losses) on cash flow hedges	5.1	(0.3)	3.4	(1.4)
Other comprehensive loss	(0.2)	(3.2)	(3.8)	(6.1)
Comprehensive loss	$ (35.1)	$ (63.8)	$ (102.7)	$ (123.6)

See notes to condensed consolidated financial statements.

PALO ALTO NETWORKS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, in millions)

	Six Months Ended January 31, 2018	Six Months Ended January 31, 2017
Cash flows from operating activities		
Net loss	$ (98.9)	$ (117.5)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Share-based compensation for equity based awards	256.5	240.6
Depreciation and amortization	43.4	28.0
Cease-use loss related to facility exit	16.7	—
Amortization of debt discount and debt issuance costs	12.7	12.1
Amortization of investment premiums, net of accretion of purchase discounts	0.6	1.4
Changes in operating assets and liabilities:		
Accounts receivable, net	67.0	(37.3)
Prepaid expenses and other assets	(39.0)	(3.8)
Accounts payable	(6.4)	0.2
Accrued compensation	(4.3)	5.3
Accrued and other liabilities	46.3	31.0
Deferred revenue	223.2	257.8
Net cash provided by operating activities	517.8	417.8
Cash flows from investing activities		
Purchases of investments	(372.5)	(562.7)
Proceeds from maturities of investments	341.8	384.0
Purchases of property, equipment, and other assets	(57.8)	(65.6)
Net cash used in investing activities	(88.5)	(244.3)
Cash flows from financing activities		
Repurchases of common stock	(259.1)	(170.1)
Proceeds from sales of shares through employee equity incentive plans	23.4	23.6
Payments for taxes related to net share settlement of equity awards	(22.9)	—
Net cash used in financing activities	(258.6)	(146.5)
Net increase in cash and cash equivalents	170.7	27.0
Cash and cash equivalents—beginning of period	744.3	734.4
Cash and cash equivalents—end of period	$ 915.0	$ 761.4
Non-cash investing and financing activities		
Property and equipment acquired through lease incentives	$ 37.8	$ —

See notes to condensed consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

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 and Principles of Consolidation

The accompanying condensed consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles ("GAAP"), consistent in all material respects with those applied in our Annual Report on Form 10-K for the fiscal year ended July 31, 2017, filed with the Securities and Exchange Commission ("SEC") on September 7, 2017. Our condensed consolidated financial statements include our accounts and our wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Our condensed consolidated financial statements are unaudited, but include all adjustments of a normal recurring nature necessary for a fair presentation of our quarterly results. We have made estimates and judgments affecting the amounts reported in our condensed consolidated financial statements and the accompanying notes. The actual results that we experience may differ materially from our estimates. Certain prior-period amounts have been reclassified to conform to current-period presentation.

Our condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes in our Annual Report on Form 10-K for the fiscal year ended July 31, 2017.

Summary of Significant Accounting Policies

There have been no material changes to our significant accounting policies as of and for the six months ended January 31, 2018, as compared to the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended July 31, 2017.

Recently Adopted Accounting Pronouncements

Derivatives and Hedging

In August 2017, the Financial Accounting Standards Board ("FASB") issued new authoritative guidance on derivatives and hedging to better align an entity's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships, and the presentation of hedge results. We early adopted the standard in our second quarter of fiscal 2018 on a modified retrospective basis. The adoption of this standard did not have a material impact on our condensed consolidated financial statements.

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 in 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 condensed 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 in 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 condensed 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 in 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. The adoption of this standard may have a material impact on our condensed consolidated financial statements, subject to any potential intra-entity transfers of assets (excluding inventory) and additional guidance and interpretations issued by U.S. regulatory and standard-setting bodies related to the Tax Cuts and Jobs Act ("TCJA") enacted into law on December 22, 2017. Refer to Note 9. Income Taxes for more information on the TCJA.

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 in 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 condensed 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 in 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 condensed 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 in 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 condensed 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, as well as guidance on the recognition of costs related to obtaining and fulfilling customer contracts. The standard also requires expanded disclosures about the nature, amount, timing, and uncertainty of revenues and cash flows arising from customer contracts, including significant judgments and changes in judgments, and assets recognized from costs incurred to obtain or fulfill a contract. The standard is effective for us in 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").

We will adopt the standard in our first quarter of fiscal 2019 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 condensed 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 condensed 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 January 31, 2018 and July 31, 2017 (in millions):

	January 31, 2018				July 31, 2017			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Cash equivalents:								
Money market funds	$ 325.7	$ —	$ —	$ 325.7	$ —	$ —	$ —	$ —
U.S. government and agency securities	—	3.5	—	3.5	—	—	—	—
Total cash equivalents	325.7	3.5	—	329.2	—	—	—	—
Short-term investments:								
Certificates of deposit	—	5.4	—	5.4	—	—	—	—
Corporate debt securities	—	183.3	—	183.3	—	159.4	—	159.4
U.S. government and agency securities	—	532.0	—	532.0	—	471.3	—	471.3
Total short-term investments	—	720.7	—	720.7	—	630.7	—	630.7
Prepaid expenses and other current assets:								
Foreign currency forward contracts	—	4.7	—	4.7	—	—	—	—
Total prepaid expenses and other current assets	—	4.7	—	4.7	—	—	—	—
Long-term investments:								
Certificates of deposit	—	—	—	—	—	5.4	—	5.4
Corporate debt securities	—	166.8	—	166.8	—	186.5	—	186.5
U.S. government and agency securities	—	555.5	—	555.5	—	597.4	—	597.4
Total long-term investments	—	722.3	—	722.3	—	789.3	—	789.3
Total assets measured at fair value	$ 325.7	$ 1,451.2	$ —	$ 1,776.9	$ —	$ 1,420.0	$ —	$ 1,420.0
Accrued and other liabilities:								
Foreign currency forward contracts	$ —	$ 0.1	$ —	$ 0.1	$ —	$ —	$ —	$ —
Total accrued and other liabilities	—	0.1	—	0.1	—	—	—	—
Total liabilities measured at fair value	$ —	$ 0.1	$ —	$ 0.1	$ —	$ —	$ —	$ —

As of January 31, 2018, we did not have any assets required to be measured at fair value on a nonrecurring basis. 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 fiscal 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. We did not have any liabilities required to be measured at fair value on a nonrecurring basis as of January 31, 2018 and July 31, 2017.

Refer to Note 5. Convertible Senior Notes for the carrying amount and estimated fair value of our convertible senior notes as of January 31, 2018 and July 31, 2017.

3. Cash Equivalents and Investments

The following tables summarize the amortized cost, unrealized gains and losses, and fair value of our available-for-sale securities as of January 31, 2018 and July 31, 2017 (in millions):

	January 31, 2018			
	Amortized Cost	**Unrealized Gains**	**Unrealized Losses**	**Estimated Fair Value**
Cash equivalents:				
Money market funds	$ 325.7	$ —	$ —	$ 325.7
U.S. government and agency securities	3.5	—	—	3.5
Total cash equivalents	$ 329.2	$ —	$ —	$ 329.2
Investments:				
Certificates of deposit	$ 5.4	$ —	$ —	$ 5.4
Corporate debt securities	352.1	0.1	(2.1)	350.1
U.S. government and agency securities	1,095.4	—	(7.9)	1,087.5
Total investments	$ 1,452.9	$ 0.1	$ (10.0)	$ 1,443.0

	July 31, 2017			
	Amortized Cost	**Unrealized Gains**	**Unrealized Losses**	**Estimated Fair Value**
Investments:				
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 investments	$ 1,422.7	$ 0.4	$ (3.1)	$ 1,420.0

Unrealized losses related to these securities 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 securities before recovery of their amortized cost basis, which may be at maturity. As a result, there were no other-than-temporary impairments for these securities at January 31, 2018 and July 31, 2017.

The following table summarizes the amortized cost and fair value of our available-for-sale securities as of January 31, 2018, by contractual years-to-maturity (in millions):

	Amortized Cost	**Fair Value**
Due within one year	$ 1,052.1	$ 1,049.9
Due between one and three years	730.0	722.3
Total	$ 1,782.1	$ 1,772.2

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 13 months or less which we designate as cash flow hedges to manage the foreign currency exchange rate risk associated with these expenditures.

These 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 derivative financial instruments are recorded at fair value, on a gross basis, as either assets or liabilities in our condensed consolidated balance sheets. Gains or losses related to our cash flow hedges are recorded as a component of accumulated other comprehensive income (loss) ("AOCI") in our condensed consolidated balance sheets and are reclassified into the financial statement line item associated with the underlying hedged transaction in our condensed consolidated statements of operations when the underlying hedged transaction is recognized in earnings. If it becomes probable that the hedged transaction will not occur, the cumulative unrealized gain or loss is reclassified immediately from AOCI into the financial statement line item associated with the underlying hedged transaction in our condensed consolidated statements of operations. Gains or losses related to non-designated derivative instruments are recognized in other income (expense), net in our condensed consolidated statements of operations for 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 condensed consolidated statements of cash flows in the same manner as the underlying hedged transaction, primarily within cash flows from operating activities.

As of January 31, 2018, the total notional amount of our outstanding foreign currency forward contracts was $149.4 million. We did not have any forward contracts outstanding as of July 31, 2017. Refer to Note 2. Fair Value Measurements for the fair value of our derivative instruments as reported in our condensed consolidated balance sheets as of January 31, 2018.

During the three and six months ended January 31, 2018 and 2017, both unrealized gains (losses) recognized in AOCI related to our cash flow hedges and amounts reclassified into earnings were not material. Total unrealized gains (losses) in AOCI related to our cash flow hedges as of January 31, 2018 and 2017 were not material.

5. 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 mature on July 1, 2019 unless converted or repurchased in accordance with their terms prior to such date. The Notes do not contain any financial covenants and 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 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. As of January 31, 2018, all of the Notes remained outstanding.

The sale price condition was met during the fiscal quarter ended January 31, 2018, and as a result, holders may convert their Notes at any time during the fiscal quarter ending April 30, 2018. Accordingly, the net carrying amount of the Notes was reclassified into current liabilities and the portion of the equity component representing the conversion option was reclassified into temporary equity in our condensed consolidated balance sheets as of January 31, 2018. The portion of the equity component classified as temporary equity is measured as the difference between the principal and net carrying amount of the Notes, excluding debt issuance costs. The sale price condition was not met during the fiscal quarter ended July 31, 2017. 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 condensed consolidated balance sheets as of July 31, 2017.

The following table sets forth the components of the Notes as of January 31, 2018 and July 31, 2017 (in millions):

	January 31, 2018	July 31, 2017
Liability:		
Principal	$ 575.0	$ 575.0
Less: debt discount and debt issuance costs, net of amortization	37.6	50.3
Net carrying amount	$ 537.4	$ 524.7
Equity (including temporary equity)	$ 109.8	$ 109.8

The total estimated fair value of the Notes was $839.6 million and $747.5 million at January 31, 2018 and July 31, 2017, 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 January 31, 2018 and July 31, 2017 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 January 31, 2018, the if-converted value of the Notes exceeded its principal amount by $218.2 million.

The following table sets forth interest expense recognized related to the Notes (dollars in millions):

	Three Months Ended January 31,		Six Months Ended January 31,	
	2018	2017	2018	2017
Amortization of debt discount	$ 5.8	$ 5.5	$ 11.4	$ 10.9
Amortization of debt issuance costs	0.6	0.6	1.3	1.2
Total interest expense recognized	$ 6.4	$ 6.1	$ 12.7	$ 12.1
Effective interest rate of the liability component	4.8%	4.8%	4.8%	4.8%

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.

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.

For more information on the Notes, the Note Hedges, and the Warrants, refer to Note 8. Convertible Senior Notes included in Part II, Item 8 of our Annual Report on Form 10-K for the fiscal year ended July 31, 2017.

6. 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 and October 2015, we entered into a total of three lease agreements for approximately 941,000 square feet of corporate office space in Santa Clara, California, which serves as our new corporate headquarters. The leases contain rent holiday periods, scheduled rent increases, lease incentives, and renewal options which allow the lease terms to be extended beyond their expiration dates of July 2028 through July 2046. In September 2017, per the terms of the lease agreements, the landlords exercised their option to amend our lease payment schedules and eliminate our rent holiday periods, which increased our rental payments by $24.4 million, $11.8 million, and $2.0 million for fiscal 2018, 2019, and 2020, respectively. In exchange, we received an upfront cash reimbursement of $38.2 million during the three months ended October 31, 2017, which we will apply against the future additional rental payments when due. As amended, rental payments under the three lease agreements are approximately $412.0 million over the lease terms.

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 contains scheduled rent increases, lease incentives, and renewal options which allow the lease term to be extended beyond the expiration date of April 2021 through July 2046. Rental payments under the lease agreement are approximately $23.1 million over the lease term. In December 2017, we entered into an agreement to sublease this office space for the remaining lease term. Proceeds from this sublease will be approximately $16.3 million over the sublease 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 contain rent holiday periods and two separate five-year options to extend the lease terms beyond their expiration dates of July 2023. Rental payments under these lease agreements are approximately $94.3 million over the lease term. In August 2017, we exited our previous headquarter facilities and relocated to our new corporate campus, which resulted in the recognition of a cease-use loss of $15.4 million as general administrative expense in our condensed consolidated statements of operations during the three months ended October 31, 2017, and a corresponding liability in our condensed consolidated balance sheets. The cease-use loss of $15.4 million was calculated as the present value of the excess of the remaining lease obligation for the vacated facilities, adjusted for the effects of any deferred items recognized under the leases and related costs, over the estimated sublease rentals that could be reasonably obtained. The amount of the cease-use loss may vary if the timing or amount of estimated cash flows change. During the three and six months ended January 31, 2018, we released $2.7 million and $4.6 million, respectively, of the cease-use liability through rental payments. As of January 31, 2018, the remaining balance of the cease-use liability was $10.8 million, which is expected to be paid through the end of the lease term in July 2023.

The following table presents details of the aggregate future non-cancelable minimum rental payments under our operating leases as of January 31, 2018 (in millions):

		Amount
Fiscal years ending July 31:		
Remaining 2018	$	32.1
2019		65.8
2020		66.1
2021		60.2
2022		56.8
2023 and thereafter		267.9
Committed gross lease payments		548.9
Less: proceeds from sublease rentals		15.4
Net operating lease obligation	$	533.5

Manufacturing Purchase Commitments

Our electronics manufacturing service provider ("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 January 31, 2018, our purchase commitments under such orders were $121.5 million, 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 January 31, 2018, 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.

7. Stockholders' Equity

Share Repurchase

In August 2016, our board of directors authorized a $500.0 million share repurchase that is funded from available working capital. In February 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 three and six months ended January 31, 2018, we repurchased and retired 0.9 million and 1.7 million shares, respectively, of our common stock under the authorization for an aggregate purchase price of $125.0 million and $250.0 million, respectively, 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 condensed consolidated balance sheets. As of January 31, 2018, $330.0 million remained available for future share repurchases under the repurchase authorization.

8. Equity Award Plans

2012 Employee Stock Purchase Plan

Our 2012 Employee Stock Purchase Plan was adopted by our board of directors and approved by the stockholders on June 5, 2012, and was effective upon completion of our initial public offering ("IPO"). On August 29, 2017, we amended and restated our 2012 Employee Stock Purchase Plan (our "2012 ESPP") to extend the length of our offering periods from six to 24 months. Under our 2012 ESPP, each 24-month offering period consists of four consecutive six-month purchase periods, with purchase dates on the first trading day on or after February 28 and August 31 of each year. 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 purchase date. If the fair market value of our common stock on the purchase date is lower than the first trading day of the offering period, the current offering period will be cancelled after purchase and a new 24-month offering period will begin. 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 per six-month purchase period and $25,000 worth of stock for each calendar year.

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):

	Options Outstanding			
	Number of Shares	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Balance—July 31, 2017	1.6	$ 13.11	4.2	$ 190.6
Options granted	—	$ —		
Options forfeited	—	$ —		
Options exercised	(0.2)	$ 11.11		
Balance—January 31, 2018	1.4	$ 13.41	3.8	$ 201.5
Options exercisable—January 31, 2018	1.4	$ 13.41	3.8	$ 201.5

Restricted Stock Award ("RSA"), Performance-Based Stock Award ("PSA"), Restricted Stock Unit ("RSU"), and Performance-Based Stock Unit ("PSU") Activities

Our PSAs and PSUs vest over a period of four years from the date of grant. The actual number of PSAs and PSUs earned and eligible to vest are determined based on level of achievement against a pre-established billings target for the fiscal year in which the awards are granted. We recognize share-based compensation expense for our PSAs and PSUs 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.

The following table summarizes the RSA, PSA, RSU, and PSU activity under our stock plans during the reporting period (in millions, except per share amounts):

	RSAs and PSAs Outstanding		RSUs and PSUs Outstanding			
	Number of Shares	Weighted-Average Grant-Date Fair Value Per Share	Number of Shares	Weighted-Average Grant-Date Fair Value Per Share	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Balance—July 31, 2017	1.0	$ 163.55	6.5	$ 141.16	1.3	$ 854.1
Granted[(1)]	—	$ —	2.4	$ 146.94		
Vested	(0.2)	$ 167.69	(1.9)	$ 136.33		
Forfeited	(0.2)	$ 156.56	(0.4)	$ 142.34		
Balance—January 31, 2018	0.6	$ 164.01	6.6	$ 144.59	1.5	$ 1,040.7

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(1) For PSAs and PSUs, shares granted represents the aggregate maximum number of shares that may be earned and issued with respect to these awards over their full terms.

Share-Based Compensation

The following table summarizes share-based compensation included in costs and expenses (in millions):

	Three Months Ended January 31,		Six Months Ended January 31,	
	2018	2017	2018	2017
Cost of product revenue	$ 1.9	$ 2.0	$ 3.8	$ 3.7
Cost of subscription and support revenue	19.9	15.0	35.8	27.3
Research and development	35.5	41.3	73.0	79.3
Sales and marketing	53.3	49.7	104.5	93.5
General and administrative	20.2	19.3	39.4	36.8
Total share-based compensation	$ 130.8	$ 127.3	$ 256.5	$ 240.6

As of January 31, 2018, total compensation cost related to unvested share-based awards not yet recognized was $976.2 million. This cost is expected to be amortized on a straight-line basis over a weighted-average period of approximately 2.7 years.

9. Income Taxes

Our provision for income taxes for the three and six months ended January 31, 2018 reflects an effective tax rate of (4.8)% and (11.0)%, respectively. Our effective tax rates for these periods were negative as we recorded a provision for income taxes on year to date losses. The key components of our income tax provision primarily consist of foreign income taxes, withholding taxes, amortization of our deferred tax charges, and a one-time tax benefit during the three months ended January 31, 2018, resulting from new tax legislation enacted during the period. Our effective tax rate differs from the U.S. statutory tax rate primarily due to changes in non-deductible share-based compensation, foreign income at other than U.S. tax rates, and changes in our valuation allowance.

Our provision for income taxes for the three and six months ended January 31, 2017 reflects an effective tax rate of (4.8)% and (6.5)%, respectively. Our effective tax rates for these periods were negative as we recorded a provision for income taxes on year to date losses. The key components of our income tax provision primarily consisted of foreign income taxes, withholding taxes, and amortization of our deferred tax charges.

On December 22, 2017, the TCJA was enacted into law. The TCJA provides for significant tax law changes and modifications including, but not limited to, the reduction of the U.S. federal corporate statutory tax rate from 35% to 21% as of January 1, 2018, the requirement for companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred, and the creation of new taxes on certain foreign-sourced earnings. As a fiscal year-end taxpayer, certain provisions of the TCJA began to impact us during the three months ended January 31, 2018, while other provisions will impact us beginning in our fiscal year ending July 31, 2019.

As a result of the TCJA, we recorded a one-time provisional benefit of $6.2 million for the three months ended January 31, 2018, relating to alternative minimum tax credits that will be refundable if not utilized. We expect adjustments to our deferred tax assets resulting from the TCJA to be offset by a corresponding adjustment to our valuation allowance. We have not recorded any amounts relating to the transition tax because we had no unremitted earnings as of the measurement date, based on our current estimate.

Accounting standards require companies to recognize the effect of tax law changes in the period of enactment. However, the SEC staff issued guidance which will allow companies to record provisional amounts during a measurement period not to extend beyond one year from the enactment date. In accordance with the guidance, we have determined the amounts recorded and positions taken, as discussed, are provisional as of January 31, 2018. The final impact of the TCJA recorded by us may differ from the provisional amounts due to a number of uncertainties and factors, including information not available until the close of our fiscal year ending July 31, 2018, the need for further guidance and clarification of the new law by U.S. federal and state tax authorities, and the need for further guidance on the related income tax accounting.

In addition to the previously discussed impacts on our fiscal year ending January 31, 2018, the TCJA also establishes new tax laws that will be effective beginning with our fiscal year ending July 31, 2019, including a provision for low-taxed income of foreign subsidiaries. Due to its complexity, we are continuing to evaluate this provision of the TCJA. Based on recent FASB deliberations, we will be allowed to make an accounting policy election to either (i) treat taxes due on future U.S. inclusions in taxable income as a current-period expense when incurred or (ii) factor such amounts into our measurement of deferred taxes. Our selection of accounting policy will depend, in part, on analyzing our facts and circumstances to determine the expected impact under each method.

10. 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):

	Three Months Ended January 31,		Six Months Ended January 31,	
	2018	2017	2018	2017
Net loss	$ (34.9)	$ (60.6)	$ (98.9)	$ (117.5)
Weighted-average shares used to compute net loss per share, basic and diluted	91.1	90.7	91.0	90.2
Net loss per share, basic and diluted	$ (0.38)	$ (0.67)	$ (1.09)	$ (1.30)

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):

	Three and Six Months Ended January 31,	
	2018	2017
RSUs and PSUs	6.6	6.7
Convertible senior notes	5.2	5.2
Warrants related to the issuance of convertible senior notes	5.2	5.2
Options to purchase common stock	1.4	1.7
RSAs and PSAs	0.6	1.2
ESPP shares	0.2	0.1
Total	19.2	20.1

ITEM 2. 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 condensed consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q. The following discussion and analysis contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements include, among other things: expectations regarding drivers of and factors affecting growth in our business; the performance advantages of our products and subscription and support offerings and the potential benefits to our customers; statements regarding trends in billings, our mix of product and subscription and support revenue, cost of revenue, gross margin, cash flows, operating expenses, including future share-based compensation expense, income taxes, including our ongoing assessment of the impact of the TCJA and any future adjustments, investment plans and liquidity; expectations regarding the seasonality and cyclicality of our revenues from quarter to quarter; expectations and intentions with respect to the products and technologies that we acquire and introduce; expected impact of the adoption of certain recent accounting pronouncements and the anticipated timing of adopting such standards; expected recurring revenues resulting from expected growth in our installed base and increased adoption of our products and cloud-based subscription services; the sufficiency of our existing cash and investments to meet our cash needs for the foreseeable future; our plans to use the upfront cash reimbursement received from our landlords against future rental payments; and other statements regarding our future operations, financial condition and prospects, and business strategies. Forward-looking statements generally can be identified by words such as "anticipates," "believes," "could," "estimates," "expects," "intends," "may," "plans," "predicts," "projects," "would," "will be," "will continue," "will likely result," and similar expressions. These forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties, which could cause our actual results to differ materially from those reflected in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this Quarterly Report on Form 10-Q, and in particular, the risks discussed under the caption "Risk Factors" in Part II, Item 1A of this report and those discussed in other documents we file with the Securities and Exchange Commission ("SEC"). 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.

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 generally accepted accounting principles ("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 the three and six months ended January 31, 2018 to the three and six months ended January 31, 2017.
- ***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 January 31, 2018, 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 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. 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.

For the second quarter of fiscal 2018 and 2017, total revenue was $542.4 million and $422.6 million, respectively, representing year-over-year growth of 28.3%. 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 January 31, 2018, we had approximately 48,000 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, subscriptions, and support to our distributors, which, in turn, sell to our resellers, which then sell to our end-customers.

Our product revenue was $202.2 million, or 37.3% of total revenue, for the second quarter of fiscal 2018, representing year-over-year growth of 19.8%. 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 was $340.2 million, or 62.7% of total revenue, for the second quarter of fiscal 2018, representing year-over-year growth of 34.0%. Our subscriptions provide our end-customers with real-time access to the latest antivirus, intrusion prevention, web filtering, and modern malware prevention capabilities across the network, endpoints, and the cloud. When end-customers purchase our physical or virtual firewall appliances, they typically purchase support in order to receive ongoing security updates, upgrades, bug fixes, and repairs. In addition to the subscriptions purchased with these appliances, end-customers may also purchase other subscriptions on a per-user, per-endpoint, or capacity-based basis.

We continue our investment in innovation as we evolve and further extend the capabilities of 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. We introduced several new offerings during the first two quarters of fiscal 2018, including: the release of our GlobalProtect cloud service subscription, which provides our Next-Generation Security Platform as a cloud-based service for remote offices and mobile users; the release of our Logging Service subscription, which functions as the central cloud-based repository for application data and logs generated by our security offerings, including those of our firewalls and GlobalProtect cloud service subscription, and allows end-customers to collect data without needing to plan for local processing power and storage; and the launch of Magnifier, a cloud-based subscription that enables organizations to identify and prevent behavior-based threats by applying machine learning to rich network, endpoint, and cloud data. In addition, in February 2018, we introduced PAN-OS 8.1, with over 60 new features, and several new models of appliances, including the PA-3200 series with three models. The new hardware appliances increase SSL decryption throughput, bring higher performance and capacity for securing large data centers, and provide additional capabilities for managing large firewall deployments. We also recently announced expanded capabilities of our platform with extended protections to the Google Cloud Platform in addition to enhanced capabilities for AWS and Azure environments to enable customers to easily integrate with their cloud infrastructure and workloads in multi-cloud environments.

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 II, Item 1A of this Quarterly Report on Form 10-Q.

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."

	January 31, 2018		July 31, 2017	
	(in millions)			
Total deferred revenue	$	1,996.7	$	1,773.5
Cash, cash equivalents, and investments	$	2,358.0	$	2,164.3

	Three Months Ended January 31,				Six Months Ended January 31,			
	2018		2017		2018		2017	
	(dollars in millions)							
Total revenue	$	542.4	$	422.6	$	1,047.9	$	820.7
Total revenue year-over-year percentage increase		28.3 %		26.3 %		27.7 %		29.9 %
Gross margin		70.6 %		73.2 %		71.3 %		73.9 %
Operating loss	$	(31.8)	$	(54.4)	$	(86.1)	$	(103.4)
Operating margin		(5.9)%		(12.9)%		(8.2)%		(12.6)%
Billings	$	674.6	$	561.6	$	1,271.1	$	1,078.5
Billings year-over-year percentage increase		20.1 %		22.4 %		17.9 %		27.3 %
Cash flow provided by operating activities					$	517.8	$	417.8
Free cash flow (non-GAAP)					$	460.0	$	352.2

- ***Deferred Revenue.*** Our deferred revenue primarily 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 metric 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:

	Three Months Ended January 31,				Six Months Ended January 31,			
	2018		2017		2018		2017	
	(in millions)							
Billings:								
Total revenue	$	542.4	$	422.6	$	1,047.9	$	820.7
Add: change in total deferred revenue, net of acquired deferred revenue		132.2		139.0		223.2		257.8
Billings	$	674.6	$	561.6	$	1,271.1	$	1,078.5

- ***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:

	Six Months Ended January 31,	
	2018	**2017**
	(in millions)	
Free cash flow (non-GAAP):		
Net cash provided by operating activities	$ 517.8	$ 417.8
Less: purchases of property, equipment, and other assets	57.8	65.6
Free cash flow (non-GAAP)	$ 460.0	$ 352.2
Net cash used in investing activities	$ (88.5)	$ (244.3)
Net cash used in financing activities	$ (258.6)	$ (146.5)

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 condensed consolidated statements of operations data. The period to period comparison of results is not necessarily indicative of results for future periods.

	Three Months Ended January 31,				Six Months Ended January 31,			
	2018		2017		2018		2017	
	Amount	% of Revenue	Amount	% of Revenue	Amount	% of Revenue	Amount	% of Revenue
	(dollars in millions)							
Revenue:								
Product	$ 202.2	37.3 %	$ 168.8	39.9 %	$ 388.7	37.1 %	$ 332.6	40.5 %
Subscription and support	340.2	62.7 %	253.8	60.1 %	659.2	62.9 %	488.1	59.5 %
Total revenue	542.4	100.0 %	422.6	100.0 %	1,047.9	100.0 %	820.7	100.0 %
Cost of revenue:								
Product	63.9	11.8 %	45.8	10.8 %	121.5	11.6 %	88.0	10.7 %
Subscription and support	95.4	17.6 %	67.4	16.0 %	179.2	17.1 %	126.4	15.4 %
Total cost of revenue(1)	159.3	29.4 %	113.2	26.8 %	300.7	28.7 %	214.4	26.1 %
Total gross profit	383.1	70.6 %	309.4	73.2 %	747.2	71.3 %	606.3	73.9 %
Operating expenses:								
Research and development	96.6	17.8 %	89.9	21.3 %	190.8	18.2 %	174.1	21.2 %
Sales and marketing	265.0	48.9 %	226.7	53.6 %	523.5	49.9 %	446.8	54.4 %
General and administrative	53.3	9.8 %	47.2	11.2 %	119.0	11.4 %	88.8	10.9 %
Total operating expenses(1)	414.9	76.5 %	363.8	86.1 %	833.3	79.5 %	709.7	86.5 %
Operating loss	(31.8)	(5.9)%	(54.4)	(12.9)%	(86.1)	(8.2)%	(103.4)	(12.6)%
Interest expense	(6.4)	(1.2)%	(6.1)	(1.4)%	(12.7)	(1.2)%	(12.1)	(1.5)%
Other income, net	4.9	1.0 %	2.7	0.6 %	9.7	0.9 %	5.2	0.7 %
Loss before income taxes	(33.3)	(6.1)%	(57.8)	(13.7)%	(89.1)	(8.5)%	(110.3)	(13.4)%
Provision for income taxes	1.6	0.3 %	2.8	0.6 %	9.8	0.9 %	7.2	0.9 %
Net loss	$ (34.9)	(6.4)%	$ (60.6)	(14.3)%	$ (98.9)	(9.4)%	$ (117.5)	(14.3)%

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(1) Includes share-based compensation as follows:

	Three Months Ended January 31,		Six Months Ended January 31,	
	2018	2017	2018	2017
Cost of product revenue	$ 1.9	$ 2.0	$ 3.8	$ 3.7
Cost of subscription and support revenue	19.9	15.0	35.8	27.3
Research and development	35.5	41.3	73.0	79.3
Sales and marketing	53.3	49.7	104.5	93.5
General and administrative	20.2	19.3	39.4	36.8
Total share-based compensation	$ 130.8	$ 127.3	$ 256.5	$ 240.6

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.

	Three Months Ended January 31,				Six Months Ended January 31,			
	2018	2017	Change		2018	2017	Change	
	Amount	Amount	Amount	%	Amount	Amount	Amount	%
	(dollars in millions)							
Product	$ 202.2	$ 168.8	$ 33.4	19.8%	$ 388.7	$ 332.6	$ 56.1	16.9%

Product revenue increased for the three and six months ended January 31, 2018 compared to the three and six months ended January 31, 2017. The increase in both periods was primarily driven by demand for our newly introduced 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.

	Three Months Ended January 31,				Six Months Ended January 31,			
	2018	2017	Change		2018	2017	Change	
	Amount	Amount	Amount	%	Amount	Amount	Amount	%
	(dollars in millions)							
Subscription	$ 183.3	$ 134.3	$ 49.0	36.5%	$ 352.6	$ 255.5	$ 97.1	38.0%
Support	156.9	119.5	37.4	31.3%	306.6	232.6	74.0	31.8%
Total subscription and support	$ 340.2	$ 253.8	$ 86.4	34.0%	$ 659.2	$ 488.1	$ 171.1	35.1%

Subscription and support revenue increased for the three and six months ended January 31, 2018 compared to the three and six months ended January 31, 2017. The increase in both periods was 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

	Three Months Ended January 31,				Six Months Ended January 31,			
	2018	2017	Change		2018	2017	Change	
	Amount	Amount	Amount	%	Amount	Amount	Amount	%
	(dollars in millions)							
Americas	$ 371.3	$ 295.0	$ 76.3	25.9%	$ 722.6	$ 575.2	$ 147.4	25.6%
EMEA	106.3	78.8	27.5	34.9%	201.7	149.5	52.2	34.9%
APAC	64.8	48.8	16.0	32.8%	123.6	96.0	27.6	28.8%
Total revenue	$ 542.4	$ 422.6	$ 119.8	28.3%	$ 1,047.9	$ 820.7	$ 227.2	27.7%

With respect to geographic theaters, the Americas contributed the largest portion of the increase in revenue for the three and six months ended January 31, 2018 compared to the three and six months ended January 31, 2017, due to its larger and more established sales force compared to our other theaters. Revenue from both Europe, the Middle East, and Africa ("EMEA") and Asia Pacific and Japan ("APAC") increased for the three and six months ended January 31, 2018 compared to the three and six months ended January 31, 2017, 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.

	Three Months Ended January 31,				Six Months Ended January 31,			
	2018	2017	Change		2018	2017	Change	
	Amount	Amount	Amount	%	Amount	Amount	Amount	%
				(dollars in millions)				
Cost of product revenue	$ 63.9	$ 45.8	$ 18.1	39.5 %	$ 121.5	$ 88.0	$ 33.5	38.1 %
Number of employees at period end	91	92	(1)	(1.1)%	91	92	(1)	(1.1)%

Cost of product revenue increased for the three and six months ended January 31, 2018 compared to the three and six months ended January 31, 2017. The increase in both periods was primarily due to higher product costs related to our newly introduced 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, data center and hosting 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 and adoption of our cloud-based subscription offerings increases.

	Three Months Ended January 31,				Six Months Ended January 31,			
	2018	2017	Change		2018	2017	Change	
	Amount	Amount	Amount	%	Amount	Amount	Amount	%
				(dollars in millions)				
Cost of subscription and support revenue	$ 95.4	$ 67.4	$ 28.0	41.5%	$ 179.2	$ 126.4	$ 52.8	41.8%
Number of employees at period end	813	623	190	30.5%	813	623	190	30.5%

Cost of subscription and support revenue increased for the three and six months ended January 31, 2018 compared to the three and six months ended January 31, 2017. The increase in both periods was driven by an increase in personnel costs, which grew $14.6 million to $54.3 million for the three months ended January 31, 2018 compared to the three months ended January 31, 2017, and grew $27.2 million to $101.4 million for the six months ended January 31, 2018 compared to the six months ended January 31, 2017. The increase in personnel costs in both periods was primarily due to headcount growth. The remaining increase in both periods was primarily due to costs to expand our customer service capabilities and infrastructure and allocated costs. The increase in allocated costs in both periods was primarily due to our expansion of facilities to support the growth of our business.

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 introduction of new products, manufacturing costs, the average sales price of our 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.

	Three Months Ended January 31,				Six Months Ended January 31,			
	2018		2017		2018		2017	
	Amount	Gross Margin	Amount	Gross Margin	Amount	Gross Margin	Amount	Gross Margin
	(dollars in millions)							
Product	$ 138.3	68.4%	$ 123.0	72.9%	$ 267.2	68.7%	$ 244.6	73.5%
Subscription and support	244.8	72.0%	186.4	73.4%	480.0	72.8%	361.7	74.1%
Total gross profit	$ 383.1	70.6%	$ 309.4	73.2%	$ 747.2	71.3%	$ 606.3	73.9%

Product gross margin decreased for the three and six months ended January 31, 2018 compared to the three and six months ended January 31, 2017, driven by higher product costs related to our newly introduced appliances, which have lower product margins.

Subscription and support gross margin decreased for the three and six months ended January 31, 2018 compared to the three and six months ended January 31, 2017, primarily due to higher costs related to the expansion of our infrastructure to support the adoption of our cloud-based subscription offerings.

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 January 31, 2018, we expect to recognize approximately $976.2 million of share-based compensation expense over a weighted-average period of approximately 2.7 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.

	Three Months Ended January 31,				Six Months Ended January 31,			
	2018	2017	Change		2018	2017	Change	
	Amount	Amount	Amount	%	Amount	Amount	Amount	%
	(dollars in millions)							
Research and development	$ 96.6	$ 89.9	$ 6.7	7.5%	$ 190.8	$ 174.1	$ 16.7	9.6%
Number of employees at period end	814	661	153	23.1%	814	661	153	23.1%

Research and development expense increased for the three and six months ended January 31, 2018 compared to the three and six months ended January 31, 2017. The increase in both periods was primarily due to an increase in personnel costs, which grew $3.1 million to $80.7 million for the three months ended January 31, 2018 compared to the three months ended January 31, 2017, and grew $8.9 million to $158.4 million for the six months ended January 31, 2018 compared to the six months ended January 31, 2017, as well as an increase in allocated costs. The increase in personnel costs in both periods was largely due to headcount growth. The increase in allocated costs in both periods was primarily due to our expansion of facilities to support the growth of our business.

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.

	Three Months Ended January 31,				Six Months Ended January 31,			
	2018	2017	Change		2018	2017	Change	
	Amount	Amount	Amount	%	Amount	Amount	Amount	%
	(dollars in millions)							
Sales and marketing	$ 265.0	$ 226.7	$ 38.3	16.9%	$ 523.5	$ 446.8	$ 76.7	17.2%
Number of employees at period end	2,511	2,269	242	10.7%	2,511	2,269	242	10.7%

Sales and marketing expense increased for the three and six months ended January 31, 2018 compared to the three and six months ended January 31, 2017. The increase in both periods was primarily due to an increase in personnel costs, which grew $31.3 million to $210.7 million for the three months ended January 31, 2018 compared to the three months ended January 31, 2017, and grew $63.0 million to $407.7 million for the six months ended January 31, 2018 compared to the six months ended January 31, 2017. The increase in personnel costs in both periods was largely due to headcount growth. The remaining increase in both periods 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

General and administrative expense consists primarily of personnel costs for our executive, finance, human resources, legal, and information technology organizations, professional services costs, which consist primarily of legal, auditing, accounting, and other consulting costs, and certain non-recurring general expenses. 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, and insurance, although our general and administrative expense may fluctuate as a percentage of total revenue.

	Three Months Ended January 31,				Six Months Ended January 31,			
	2018	2017	Change		2018	2017	Change	
	Amount	Amount	Amount	%	Amount	Amount	Amount	%
	(dollars in millions)							
General and administrative	$ 53.3	$ 47.2	$ 6.1	12.9%	$ 119.0	$ 88.8	$ 30.2	34.0%
Number of employees at period end	604	492	112	22.8%	604	492	112	22.8%

General and administrative expense increased for the three months ended January 31, 2018 compared to the three months ended January 31, 2017, primarily due to an increase in personnel costs, which grew $4.5 million to $38.8 million, largely due to headcount growth.

General and administrative expense increased for the six months ended January 31, 2018 compared to the six months ended January 31, 2017, primarily due to a loss of $15.4 million recognized on the lease of our previous headquarter facilities in August 2017, when we officially ceased use of such facilities. Refer to Note 6. Commitments and Contingencies in Part I, Item 1 of this Quarterly Report on Form 10-Q for more information on our cease-use loss. The remaining increase was primarily driven by an increase in personnel costs, which grew $8.4 million to $73.6 million, largely due to headcount growth, and an increase in allocated costs due to our expansion of facilities to support the growth of our business.

Provision for Income Taxes

Provision for income taxes consists primarily of income taxes in foreign jurisdictions in which we conduct business, withholding taxes, U.S. state income taxes, and amortization of our deferred tax charges. We maintain a valuation allowance for domestic and certain foreign deferred tax assets, including net operating loss carryforwards and certain domestic 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. To the extent we revisit our corporate structure, it may have an impact on our tax provision.

On December 22, 2017, the Tax Cuts and Jobs Act (“TCJA”) was enacted into law. The TCJA provides for significant tax law changes and modifications including, but not limited to, the reduction of the U.S. federal corporate statutory tax rate from 35% to 21% as of January 1, 2018, the requirement for companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred, and the creation of new taxes on certain foreign-sourced earnings. As a fiscal year-end taxpayer, certain

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provisions of the TCJA began to impact us during the three months ended January 31, 2018, while other provisions will impact us beginning in our fiscal year ending July 31, 2019.

	Three Months Ended January 31,		Change		Six Months Ended January 31,		Change	
	2018	2017	Amount	%	2018	2017	Amount	%
	(dollars in millions)							
Provision for income taxes	$ 1.6	$ 2.8	$ (1.2)	(42.9)%	$ 9.8	$ 7.2	$ 2.6	36.1%
Effective tax rate	(4.8)%	(4.8)%			(11.0)%	(6.5)%		

We recorded an income tax provision for the three and six months ended January 31, 2018. Components of our provision for income taxes include foreign income taxes, withholding taxes, amortization of our deferred tax charges, and a one-time tax benefit resulting from the TCJA for the three months ended January 31, 2018. Our provision for income taxes decreased for the three months ended January 31, 2018 compared to the three months ended January 31, 2017, primarily due to a one-time provisional benefit of $6.2 million relating to alternative minimum tax credits that will be refundable if not utilized due to the enactment of the TCJA, partially offset by overall growth in operations. Our provision for income taxes increased for the six months ended January 31, 2018 compared to the six months ended January 31, 2017, primarily due to overall growth in operations, partially offset by the aforementioned benefit from the TCJA.

During the three months ended January 31, 2018, we recognized provisional amounts for the tax effects of the TCJA which were included as components of income tax expense and reflected in the effective tax rates above. We will continue to assess the impact of the TCJA on our business and our condensed consolidated financial statements, however, the final impact of the TCJA may differ from the provisional amounts due to a number of uncertainties and factors, including information not available until the close of our fiscal year ending July 31, 2018, the need for further guidance and clarification of the new law by U.S. federal and state tax authorities, and the need for further guidance on the related income tax accounting. Refer to Note 9. Income Taxes in Part I, Item 1 of this Quarterly Report on Form 10-Q for more information on the TCJA and its expected impact.

Liquidity and Capital Resources

	January 31, 2018	July 31, 2017
	(in millions)	
Working capital(1)	$ 353.8	$ 775.0
Cash, cash equivalents, and investments:		
Cash and cash equivalents	$ 915.0	$ 744.3
Investments	1,443.0	1,420.0
Total cash, cash equivalents, and investments	$ 2,358.0	$ 2,164.3

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(1) The net carrying amount of the 0.0% Convertible Senior Notes due 2019 (the “Notes”) was classified in current liabilities in our condensed consolidated balance sheets as of January 31, 2018. Refer to Note 5. Convertible Senior Notes in Part I, Item 1 of this Quarterly Report on Form 10-Q for more information.

At January 31, 2018, our total cash, cash equivalents, and investments of $2.4 billion were held for general corporate purposes, of which approximately $357.5 million was held outside of the United States. As of January 31, 2018, we had no unremitted earnings that would be subject to taxation in the United States 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 January 31, 2018, 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. During the fiscal quarter ended January 31, 2018, one of the early conversion conditions was met, and as a result, holders may convert their Notes at any time during the fiscal quarter ending April 30, 2018. 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 5. Convertible Senior Notes in Part I, Item 1 of this Quarterly Report on Form 10-Q 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 January 31, 2018, $330.0 million remained available for future share repurchases under the repurchase authorization. Refer to Note 7. Stockholders' Equity in Part I, Item 1 of this Quarterly Report on Form 10-Q for information on the repurchase authorization.

The following table summarizes our cash flows for the six months ended January 31, 2018 and 2017:

	Six Months Ended January 31,	
	2018	2017
	(in millions)	
Net cash provided by operating activities	$ 517.8	$ 417.8
Net cash used in investing activities	(88.5)	(244.3)
Net cash used in financing activities	(258.6)	(146.5)
Net increase in cash and cash equivalents	$ 170.7	$ 27.0

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 during the six months ended January 31, 2018 was $517.8 million, an increase of $100.0 million compared to the six months ended January 31, 2017. The increase was due to growth of our business, as reflected by increases in billings and collections on accounts receivable, and the receipt of an upfront cash reimbursement of $38.2 million related to certain of our lease agreements during the six months ended January 31, 2018. The upfront cash reimbursement was received from our landlords in connection with the amendment of our lease agreements and will be applied against rental payments due in fiscal years 2018 through 2020. Refer to Note 6. Commitments and Contingencies in Part I, Item 1 of this Quarterly Report on Form 10-Q for more information.

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 the six months ended January 31, 2018 was $88.5 million, a decrease of $155.8 million compared to the six months ended January 31, 2017, due to lower net purchases of available-for-sale investments during the six months ended January 31, 2018.

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 the six months ended January 31, 2018 was $258.6 million, an increase of $112.1 million compared to the six months ended January 31, 2017, primarily due to an increase in repurchases of our common stock and payments for tax withholding obligations of certain employees related to the net share settlement of equity awards during the six months ended January 31, 2018.

Contractual Obligations and Commitments

The following table summarizes our contractual obligations and commitments as of January 31, 2018:

	Payments Due by Period				
	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
			(in millions)		
0.0% Convertible Senior Notes due 2019[1]	$ 575.0	$ —	$ 575.0	$ —	$ —
Operating lease obligations[2]	548.9	65.2	129.5	113.9	240.3
Purchase obligations[3]	121.5	121.5	—	—	—
Total[4]	$ 1,245.4	$ 186.7	$ 704.5	$ 113.9	$ 240.3

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(1) As of January 31, 2018, holders may convert their Notes at any time during the fiscal quarter ending April 30, 2018. Refer to Note 5. Convertible Senior Notes in Part I, Item 1 of this Quarterly Report on Form 10-Q for more information.

(2) Consists of contractual obligations from our non-cancelable operating leases. Excludes contractual sublease proceeds of $15.4 million, which consists of $4.3 million to be received in less than one year, $9.8 million to be received in one to three years, and $1.3 million to be received in three to five years. Refer to Note 6. Commitments and Contingencies in Part I, Item 1 of this Quarterly Report on Form 10-Q for more information on our operating leases.

(3) 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.

(4) No amounts related to income taxes are included. As of January 31, 2018, we had approximately $71.2 million of tax liabilities recorded related to uncertainty in income tax positions.

Off-Balance Sheet Arrangements

As of January 31, 2018, 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 condensed consolidated financial statements have been prepared in accordance with U.S. GAAP. The preparation of these condensed 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.

We believe the critical accounting estimates discussed under Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our Annual Report on Form 10-K for the fiscal year ended July 31, 2017, reflect our more significant judgments and estimates used in the preparation of our condensed consolidated financial statements. There have been no significant changes to our critical accounting estimates as filed in such report.

Recent Accounting Pronouncements

Refer to “Recently Issued Accounting Pronouncements” in Note 1. Description of Business and Summary of Significant Accounting Policies in Part I, Item 1 of this Quarterly Report on Form 10-Q.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our assessment of our exposures to market risk have not changed materially since the presentation set forth in Part II, Item 7A of our Annual Report on Form 10-K for the fiscal year ended July 31, 2017.

ITEM 4. 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"), as of the end of the period covered by this report. Based on our evaluation, our chief executive officer and chief financial officer concluded that, as of January 31, 2018, 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 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.

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 fiscal quarter ended January 31, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Limitations on Controls

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. Further, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected.

PART II

ITEM 1. LEGAL PROCEEDINGS

The information set forth under the “Litigation” subheading in Note 6. Commitments and Contingencies in Part I, Item 1 of this Quarterly Report on Form 10-Q is incorporated herein by reference.

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 2017 to the end of the second quarter of fiscal 2018, our headcount increased from 4,562 to 4,833 employees, and our number of end-customers increased from more than 42,500 to approximately 48,000. 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 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 referendum on June 23, 2016 in which voters in the United Kingdom (the "U.K.") approved an exit from the European Union (the "E.U."), which is commonly referred to as "Brexit," 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 "Brexit," 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 27.7% and 29.9% in the six months ended January 31, 2018 and the six months ended January 31, 2017, 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 $935.6 million at January 31, 2018. 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. 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 Systems, Inc. ("Cisco") and Juniper Networks, Inc. ("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 Corporation, Check Point Software Technologies Ltd. ("Check Point"), Fortinet, Inc., and FireEye, Inc., 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 other 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 hire, 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, integrate, 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 and work authorization laws and regulations 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 hire, 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 operating results.

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 62.9% of total revenue in the six months ended January 31, 2018 and 59.5% of total revenue in the six months ended January 31, 2017. 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 product 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 uniform resource locator ("URL") categories may falsely detect, report and act on 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 Flextronics International, Ltd. (“Flex”), our electronics manufacturing service provider (“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 manufactured by our manufacturing partners at facilities located in the United States. Some of the components in our products are sourced either through Flex or directly by us from component suppliers outside the United States. The portion of our products that are sourced 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 sourcing or logistics disruption resulting from import delays or the imposition of increased tariffs on our sourcing 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 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 shipment 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 current 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, which non-compliance could include increased costs;
- 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, as a result of "Brexit," 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 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 successfully 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. As of January 31, 2018, the total notional amount of our outstanding foreign currency forward contracts was $149.4 million. Refer to Note 4. Derivative Instruments in Part I, Item 1 of this Quarterly Report on Form 10-Q 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 the six months ended January 31, 2018, three distributors represented 67.1% of our total revenue, and as of January 31, 2018, three distributors represented 72.3% 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 government shutdowns, 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. Additionally, the U.S. government may require certain of the products that it purchases 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 failure 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., and in February 2017 we acquired LightCyber Ltd. ("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 and operations 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 an office 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 Internet Protocol (“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 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 effective 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, but not limited to, the Tax Cuts and Jobs Act ("TCJA") and 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 condensed consolidated financial statements and may materially affect our financial results in the period or periods for which such determination is made.

In addition, our future income tax obligations could be adversely affected by changes in tax laws in the United States or in other jurisdictions in which we operate. In the United States, the TCJA contains many significant changes to the U.S. federal income tax laws, the consequences of which, to us, have not yet been fully determined and which could have material impact on the value of our deferred tax assets and could increase our future U.S. income tax expense. Furthermore, changes to the taxation of undistributed foreign earnings, if any, could change our future intentions regarding reinvestment of such earnings. The foregoing items could have a material adverse effect on our business, cash flows, results of operations, or financial condition.

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 condensed 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 I, Item 2 of this Quarterly Report on Form 10-Q. 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, an armed conflict, 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 variations 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 Quarterly Report on Form 10-Q 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 February 15, 2018. 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.

In February 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 (the “Note Hedges”) with certain counterparties. We also entered into warrant transactions with the counterparties pursuant to which we sold warrants (the “Warrants”) for the purchase of our common stock. The Note Hedges 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 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

The following table summarizes stock repurchases during the three months ended January 31, 2018 (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[(1)]	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs[(1)]
November 1, 2017 to November 30, 2017[(2)(3)]	0.1	$ 144.15	0.1	$ 447.5
December 1, 2017 to December 31, 2017[(2)(3)]	0.8	$ 144.74	0.8	$ 330.0
January 1, 2018 to January 31, 2018[(2)]	—	$ 157.22	—	$ 330.0
Total	0.9	$ 144.74	0.9	

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(1) In August 2016, we announced that our board of directors authorized a $500.0 million share repurchase that is funded from available working capital. In February 2017, we announced that our board of directors authorized a $500.0 million increase to the 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) Includes 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) Includes repurchases under our share repurchase program, for which the average price paid per share excludes costs associated with the repurchases.

ITEM 6. EXHIBITS

Exhibit Number	Exhibit Description	Incorporated by Reference			
		Form	File No.	Exhibit	Filing Date
10.1*	Offer Letter between the Registrant and Kathleen Bonanno, dated November 17, 2017.	8-K	001-35594	10.1	November 20, 2017
10.2*	Executive Incentive Plan effective December 8, 2017.				
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.				
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.

† The certifications attached as Exhibit 32.1 and 32.2 that accompany this Quarterly Report on Form 10-Q are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference into any filing of Palo Alto Networks, Inc. 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 Quarterly Report on Form 10-Q, irrespective of any general incorporation language contained in such filing.

SIGNATURES

Pursuant to the requirements 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.

Date: February 26, 2018

PALO ALTO NETWORKS, INC.

By: /s/ KATHLEEN BONANNO

Kathleen Bonanno
Chief Financial Officer
(Duly Authorized Officer and Principal Financial Officer)

Date: February 26, 2018

PALO ALTO NETWORKS, INC.

By: /s/ JEAN COMPEAU

Jean Compeau
Chief Accounting Officer
(Duly Authorized Officer and Principal Accounting Officer)

Exhibit 10.2

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 68 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.

Exhibit 31.1

CERTIFICATION PURSUANT TO SECTION 302(a)
OF THE SARBANES-OXLEY ACT OF 2002

I, Mark D. McLaughlin, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Palo Alto Networks, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ MARK D. MCLAUGHLIN

Mark D. McLaughlin
Chief Executive Officer and Director

Date: February 26, 2018

Exhibit 31.2

**CERTIFICATION PURSUANT TO SECTION 302(a)
OF THE SARBANES-OXLEY ACT OF 2002**

I, Kathleen Bonanno, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Palo Alto Networks, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ KATHLEEN BONANNO

Kathleen Bonanno
Chief Financial Officer

Date: February 26, 2018

Exhibit 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

I, Mark D. McLaughlin, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q of Palo Alto Networks, Inc. for the quarterly period ended January 31, 2018, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and that information contained in such Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Palo Alto Networks, Inc.

/s/ MARK D. MCLAUGHLIN

Mark D. McLaughlin
Chief Executive Officer and Director

Date: February 26, 2018

Exhibit 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**

I, Kathleen Bonanno, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q of Palo Alto Networks, Inc. for the quarterly period ended January 31, 2018, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and that information contained in such Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Palo Alto Networks, Inc.

/s/ KATHLEEN BONANNO

Kathleen Bonanno
Chief Financial Officer

Date: February 26, 2018