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

Form 10-K

(Mark One)

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

For the fiscal year ended July 31, 2013

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.)**

3300 Olcott Street
Santa Clara, California 95054
(Address of principal executive office, including zip code)

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

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

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

Securities registered pursuant to Section 12(g) of the Act:
None

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934 (the “Exchange Act”). Yes ☐ No x

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No ☐

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

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

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

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

The aggregate market value of voting stock held by non-affiliates of the registrant was $1,873,615,675 as of the end of the Registrant's second fiscal quarter (based on the closing sales price for the common stock on the New York Stock Exchange on January 31, 2013). Shares of common stock held by each executive officer, director, and holder of 5% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

On September 10, 2013, 71,667,163 shares of the registrant’s common stock, $0.0001 par value, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the information called for by Part III of this Form 10-K is hereby incorporated by reference from the definitive proxy statement for the Registrant's annual meeting of stockholders, which will be filed with the Securities and Exchange Commission not later than 120 days after the Registrant's fiscal year ended July 31, 2013.

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PART I

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K, including the sections entitled “Business,” “Risk Factors,” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The words “believe,” “may,” “will,” “potentially,” “estimate,” “continue,” “anticipate,” “intend,” “could,” “would,” “project,” “plan” “expect,” and similar expressions that convey uncertainty of future events or outcomes are intended to identify forward-looking statements.

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

- our ability to maintain an adequate rate of revenue growth;
- our business plan and our ability to effectively manage our growth;
- trends in revenue, costs of revenue, and gross margin;
- trends in our operating expenses, including personnel costs, research and development expense, sales and marketing expense, and general and administrative expense;
- our ability to extend our leadership position in next-generation network security;
- our ability to timely and effectively scale and adapt our existing technology;
- our ability to expand internationally;
- the effects of increased competition in our market and our ability to offer differentiated products and compete effectively;
- our ability to introduce new subscriptions, renew existing contracts, and increase sales to our existing customer base;
- costs associated with defending intellectual property infringement and other claims, such as those claims discussed in “Legal Proceedings” included in Part I, Item 3 of this Annual Report on Form 10-K;
- the effects of seasonal trends and macroeconomic conditions on our results of operations;
- the adequacy of our current facilities;
- the sufficiency of our cash flow from operations with existing cash and cash equivalents to meet our cash needs for at least the next 12 months; and
- future acquisitions of, or investments in, complementary companies, products, services, or technologies.

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

ITEM 1. BUSINESS

General

We have pioneered the next generation of network security with our innovative platform that allows enterprises, service providers, and government entities to secure their networks and safely enable the increasingly complex and rapidly growing number of applications running on their networks. The core of our platform is our Next-Generation Firewall, which delivers application, user, and content visibility and control as well as protection against cyber threats integrated within the firewall through our proprietary hardware and software architecture. Our platform offers a number of compelling benefits for our end-customers, including the ability to identify, control, and safely enable applications while offering protection against cyber threats in real time. We believe our platform also offers superior performance compared to legacy approaches and reduces the total cost of ownership for organizations by simplifying their network security infrastructure and eliminating the need for multiple, stand-alone security appliances. Our products and services can address a broad range of our end-customers' network security requirements, from the data center to the network perimeter, as well as the distributed enterprise, which includes branch offices and a growing number of mobile devices.

Our platform is based on an innovative traffic classification engine that identifies network traffic by application, user, and content. As a result, it provides in-depth visibility into all traffic and all applications, at the user level, at all times, and at the full speed of the network in order to control usage, content, risks, and cyber threats. This enables our end-customers to transform their organizations by safely enabling applications through a positive security model with fine-grained policy implementation capabilities.

Our platform is delivered in the form of a hardware or virtual appliance and includes a suite of subscription services as well as support and maintenance. Our subscription services can be easily activated on any of our appliances without requiring additional hardware or processing resources, thereby providing a seamless implementation path for our end-customers. All of our appliances incorporate our PAN-OS operating system and are based on our proprietary identification technologies, application visibility and control (App-ID), user identification (User-ID), and Content-ID, which allow security policies to be defined within the context of applications, users, and content. We deliver these capabilities through an innovative, Single Pass Parallel Processing (SP3) architecture that simultaneously performs multiple identification, security, and networking functions. As a result, our end-customers achieve safe application enablement and advanced levels of cybersecurity, while maintaining high network performance.

We serve the enterprise network security market, which consists of Firewall, Unified Threat Management (UTM), Web Gateway, Intrusion Detection and Prevention (IDS/IPS), and Virtual Private Network (VPN) technologies.

We sell our platform through a high touch, channel fulfilled sales model. Our business is geographically diversified, with 63% of our total revenue from the Americas, 23% from Europe, the Middle East, and Africa (EMEA), and 14% from Asia Pacific and Japan (APAC) in fiscal 2013. As of July 31, 2013, we had over 13,500 end-customers in more than 120 countries.

We were incorporated in 2005 as Palo Alto Networks, Inc., a Delaware corporation. Our principal executive offices are located in Santa Clara, California, and our telephone number is (408) 753-4000. Our website is www.paloaltonetworks.com.

We are organized and operate in a single segment. See Note 12 to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report on Form 10-K.

Products and Services

Appliances. All firewall appliances come with the same rich set of features ensuring consistent operation across the entire product line. These features include: App-ID, User-ID, site-to-site VPN, remote access SSL VPN, and Quality-of-Service (QoS). We classify our appliances based on throughput. In addition to firewall appliances, we offer dedicated Panorama and WildFire appliances.

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

Virtual System Upgrades. Virtual System Upgrades are available as extensions to the Virtual System capacity that ships with the appliance. Virtual Systems provide a virtualization solution to our large enterprise and service provider end-customers that implement large data centers, private cloud, and public cloud security infrastructures and need to support a multi-tenant firewall environment.

Subscription Services. We offer a number of subscription services as part of our platform. These services include:

- ***Threat Prevention Subscription***. This service provides the intrusion detection and prevention capabilities of our platform. Our threat prevention engine blocks vulnerability exploits, viruses, spyware, buffer overflows, denial-of-service attacks, and port scans from compromising and damaging enterprise information resources. It includes mechanisms such as protocol decoder-based analysis, protocol anomaly-based protection, stateful pattern matching, statistical anomaly detection, heuristic-based analysis, custom vulnerability, and spyware phone home signatures.

- ***URL Filtering Subscription***. This service provides the URL filtering capabilities of our platform. The URL filtering database consists of millions of URLs across many categories and is designed to monitor and control employee web surfing activities. The on-appliance URL database can be augmented to suit the traffic patterns of the local user community with a custom URL database. URLs that are not categorized by the local URL database can be pulled into a separate, cache-based URL database from a very extensive, cloud-based URL database.

- ***GlobalProtect Subscription***. This service provides protection for mobile users of both traditional laptop devices and mobile devices. It expands the boundaries of the physical network, effectively establishing a logical perimeter that encompasses remote laptop and mobile device users irrespective of their location. When a remote user logs into the device, GlobalProtect automatically determines the closest gateway available to the roaming device and establishes a secure connection. Windows and Apple laptops as well as such mobile devices as Apple iPhones and iPads, will stay connected to the corporate network whenever they are on a network of any kind. As a result they are protected as if they never left the corporate campus. GlobalProtect ensures that the same secure application enablement policies that protect users at the corporate site are enforced for all users, independent of their location.

- ***WildFire Subscription***. This service provides protection against targeted modern malware and advanced persistent threats. Its cloud-based analysis service provides a near real-time analysis engine for detecting previously unseen modern malware. The core component of this service is a sandbox environment that can operate on an end-customers' private cloud or our public cloud where files can be run and monitored for more than 100 behavioral characteristics that identify the file as malware. Once identified, signatures are automatically generated and delivered to all devices that subscribe to the service. By providing this as a cloud-based service, all of our end-customers benefit from malware found on any network.

Support and Maintenance. We offer technical support on our products and subscriptions to our end-customers and channel partners. We offer Standard Support, Premium Support, and 4-hour Premium Support. Our channel partners that operate a Palo Alto Networks Authorized Support Center (ASC) typically deliver level-one and level-two support. We provide level-three support 24 hours a day, seven days a week through regional support centers that are located worldwide. We also offer an annual subscription-based Technical Account Management (TAM) service that provides dedicated support for end-customers with unique or complex support requirements. We offer our end-customers ongoing maintenance services for both hardware and software in order to receive ongoing security updates, PAN-OS upgrades, bug fixes, and repair. These services are typically sold to end-customers for a one-year or longer term at the time of the initial product sale and typically renew for successive one-year or longer periods. Additionally, we provide expedited replacement for any defective hardware. We use a third-party logistics provider to manage our worldwide deployment of spare appliances and other accessories.

Professional Services. Professional services include on-location, hands-on experts that plan, design, and deploy effective security solutions tailored to our end-customers' specific requirements. We generally do not directly provide such professional services to our end-customers. Instead, we primarily deliver these resources through our authorized partners. These services include application traffic management, solution design and planning, configuration, and firewall migration. Our Education Services provide classroom-style training and are primarily delivered through our authorized partners.

Major Product Development Projects

We continue to invest in innovation and strengthening our product portfolio, which resulted in several new product offerings during fiscal 2013. These new product offerings include: the VM-Series, an all-software virtualized next-generation firewall platform that brings next-generation network security into the virtualized data center environment; the paid subscription service for WildFire, our cloud-based modern malware prevention service platform; the WF-500 appliance which provides the ability to deploy WildFire in a customer's private cloud; the PA-3000 Series firewalls that provide mid-range appliance options for enterprise customers; and lastly, the M-100 management appliance, which offers an easy to deploy, high-performance, dedicated appliance for our Panorama management system.

Technology

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

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

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

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

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

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

Content-ID. Content-ID is a collection of technologies that enables many of our subscription services. Content-ID combines a real-time threat prevention engine, a cloud-based analysis service, and a comprehensive URL categorization database to limit unauthorized data and file transfers, detect and block a wide range of threats, and control non-work related web surfing.

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

Our cloud-based analysis service, called WildFire, provides a near real-time analysis engine for detecting previously unseen modern malware. The core component of WildFire is a sandbox environment that can be deployed in a customer's private cloud or on Palo Alto Networks' public cloud where files can be run and monitored for more than 100 behavioral characteristics that identify the file as malware. Once identified, signatures are automatically generated and delivered to all devices that subscribe to the WildFire service. By providing WildFire as a cloud-based service, all of our end-customers benefit from malware found on a single network.

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

SP3. SP3 has two elements: single-pass software and parallel processing hardware.

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

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

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

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

Our platform has the ability to enable a series of virtual firewall instances or virtual systems. Each virtual system is an independent (virtual) firewall within the device that is managed separately and cannot be accessed or viewed by any other administrator of any other virtual system. This capability allows enterprises and service providers to separate firewall instances in departmental and multi-tenant managed services scenarios.

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

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

Certifications. Our products have been awarded FIPS 140-2 Level 2, Common Criteria/NIAP EAL 2, Common Criteria/NIAP EAL4+, NEBS, and ICSA Firewall certifications.

Customers

We sell our platform through our channel partners to end-customers globally. Our end-customers are predominantly medium to large enterprises, service providers, and government entities. Our end-customers operate in a variety of industries, including education, energy, financial services, healthcare, Internet and media, manufacturing, public sector, and telecommunications. Our end-customers deploy our platform for a variety of security functions across a variety of deployment scenarios. Typical deployment scenarios include the enterprise perimeter, the enterprise data center, and the distributed enterprise perimeter. Our end-customer deployments typically involve at least one pair of our products along with one or more of our subscription services, depending on size, security needs and requirements, and network complexity. As of July 31, 2013, we had shipped our products to over 13,500 end-customers worldwide. No single end-customer accounted for more than 10% of our total revenue in fiscal 2013.

Backlog

Orders for services for multiple years are billed upfront shortly after receipt of an order and are included in deferred revenue. Timing of revenue recognition for services may vary depending on the contractual service period or when the services are rendered. Products are shipped and billed shortly after receipt of an order. We do not believe that our product backlog at any particular time is meaningful because it is not necessarily indicative of future revenue in any given period as such orders may be rescheduled by our partners without penalty prior to shipment or delayed due to inventory constraints. Additionally, the majority of our product revenue comes from orders that are received and shipped in the same quarter.

Sales, Customer Support and Marketing

Sales. Our sales organization is responsible for large-account acquisition and overall market development, which includes the management of the relationships with our channel partners, working with our channel partners in winning and supporting end-customers through a direct-touch approach, and acting as the liaison between the end-customers and the marketing and product development organizations. For additional information about revenue and assets by geographic region, refer to Note 12 to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report on Form 10-K. We expect to continue to grow our sales headcount in all of our principal markets and expand our presence into countries where we currently do not have a direct sales presence.

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

Channel Program. We work with channel partners that provide our platform to end-customers. We focus on building in-depth relationships with a smaller number of solutions-oriented partners that have strong network security expertise. As of July 31, 2013, we had approximately 1,250 channel partners. These channel partners are supported by our sales and marketing organization and consist of distributors and resellers with proven network security experience. Sales to these channel partners are subject to our standard, non-exclusive distributor agreement, which provides for an initial term of one year, one year renewal terms, termination by us with 30-90 days written notice prior to the renewal date, and payment to us from the channel partner within 30-45 calendar days of the date we issue an invoice for such sales. Approximately 64% of our total revenue in fiscal 2013 was derived from sales to three channel partners.

To ensure optimal productivity, we operate a formal accreditation program for our channel partners' sales and technical professionals. Around the world, we maintain a two-tier open distribution model where value-added distributors and value-added resellers work together on a non-exclusive basis to market our platform, identify and close sales opportunities, and provide pre-sales and post-sales services to our end-customers. Our channel partner program, NextWave, rewards our channel partners based on a number of attainment goals, as well as provides them access to marketing funds, technical and sales training, and support.

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

Marketing. Our marketing is focused on building our brand reputation and the market awareness of our platform, driving pipeline and end-customer demand, and operating the channel program. The marketing team consists primarily of product marketing, programs marketing, field marketing, channel marketing, and public relations functions. Marketing is responsible for the channel program NextWave, as well as the channel enablement functions. Marketing activities include pipeline development through demand generation, social media and advertising programs, managing the corporate web site and partner portal, trade shows and conferences, press, analyst, and customer relations, and customer awareness. Every six months, we publish 2 major market research papers called the "Application Usage and Risk Report" and the "Modern Malware Report," which are based on the application and cyber threat landscape of our end-customers. These activities and tools benefit both our direct and indirect channels and are available at no cost to our channel partners.

Manufacturing

The manufacturing of our security products is outsourced to various contract manufacturers and original design manufacturers. This approach allows us to reduce our costs as it reduces our manufacturing overhead and inventory and also allows us to adjust more quickly to changing end-customer demand. Our primary manufacturing partner is Flextronics International, Ltd., who assembles our products using design specifications, quality assurance programs, and standards that we establish, and procures components and assembles our products based on our demand forecasts. These forecasts represent our estimates of future demand for our products based upon historical trends and analysis from our sales and product management functions as adjusted for overall market conditions.

We have entered into a written agreement with Flextronics pursuant to which they manufacture, assemble, and test our products. This agreement has an initial term of three years, which is automatically renewed for one-year terms, unless terminated by either party giving 180 days or more notice prior to the end of the term or upon written notice, subject to applicable cure periods, if the other party has materially breached its obligations under the agreement.

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

Research and Development

Our research and development effort is focused on developing new hardware and software and on enhancing and improving our existing products. We believe that hardware and software both are critical to expanding our leadership in enterprise network security. Our engineering team has deep networking and security expertise and works closely with end-customers to identify their current and future needs. In addition to our focus on hardware and software, our research and development team is focused on research into applications and threats, which allows us to respond to the rapidly changing application and threat landscape.

We believe that innovation and timely development of new features and products is essential to meeting the needs of our end-customer and improving our competitive position. We supplement our own research and development effort with technologies and products that we license from third parties. We test our products thoroughly to certify and ensure interoperability with third-party hardware and software products.

We plan to continue to significantly invest in resources to conduct our research and development effort.

Competition

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

- large networking vendors such as Cisco Systems, Inc. and Juniper Networks, Inc. that incorporate network security features in their products;
- large companies such as Intel Corporation, International Business Machines (IBM), and Hewlett-Packard Company (HP) that have acquired large network security specialist vendors in recent years and have the technical and financial resources to bring competitive solutions to the market;
- independent network security vendors such as Check Point Software Technologies Ltd. and Fortinet, Inc. that offer network security products; and
- small and large companies that offer point solutions that compete with some of the features present in our platform.

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

The principal competitive factors in our market include:

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

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

Intellectual Property

Companies in the enterprise network 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. Our success depends in part upon our ability to protect our core technology and intellectual property. We rely on patents, trademarks, copyrights and trade secret laws, confidentiality procedures, and employee disclosure and invention assignment agreements to protect our intellectual property rights.

As of July 31, 2013, we had 19 issued patents and 55 patent applications pending in the United States. Our issued patents expire between 2017 and 2029. We cannot assure you whether any of our patent applications will result in the issuance of a patent or whether the examination process will require us to narrow our claims. Any patents that may issue may be contested, circumvented, found unenforceable or invalidated, and we may not be able to prevent third parties from infringing them. We purchased a portion of our issued U.S. patents from other entities. We also license software from third parties for integration into our products, including open source software and other software available on commercially reasonable terms.

We control access to and use of our proprietary software and other confidential information through the use of internal and external controls, including contractual protections with employees, contractors, end-customers and partners, and our software is protected by U.S. and international copyright laws. Despite our efforts to protect our trade secrets and proprietary rights through intellectual property rights, licenses, and confidentiality agreements, unauthorized parties may still copy or otherwise obtain and use our software and technology. In addition, we intend to continue to expand our international operations, and effective patent, copyright, trademark, and trade secret protection may not be available or may be limited in foreign countries.

If we become more successful, we believe that competitors will be more likely to try to develop products and services that are similar to ours and that may infringe our proprietary rights. It may also be more likely that competitors or other third parties will claim that our platform infringes their proprietary rights.

Our industry is characterized by the existence of a large number of patents and frequent claims and related litigation regarding patent and other intellectual property rights. In particular, leading companies in the network security industry have extensive patent portfolios and are regularly involved in both offensive and defensive litigation. From time to time, third parties, including certain of these leading companies, may assert patent, copyright, trademark, and other intellectual property rights against us, our channel partners, or our end-customers, which our standard license and other agreements obligate us to indemnify against such claims. Successful claims of infringement by a third party could prevent us from distributing certain products or performing certain services, require us to expend time and money to develop non-infringing solutions, or force us to pay substantial damages (including treble damages if we are found to have willfully infringed patents or copyrights), royalties or other fees. In addition, to the extent that we gain greater visibility and market exposure as a public company, we face a higher risk of being the subject of intellectual property infringement claims from third parties. We cannot assure you that we do not currently infringe, or that we will not in the future infringe, upon any third-party patents or other proprietary rights. See “Risk Factors—Claims by others that we infringe their proprietary technology or other rights could harm our business” and “—Legal Proceedings” below for additional information.

Employees

As of July 31, 2013, we had 1,147 full-time employees. None of our employees is represented by a labor organization or is a party to any collective bargaining arrangement. We have never had a work stoppage, and we consider our relationship with our employees to be good.

Available Information

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

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

ITEM 1A. RISK FACTORS

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

Risks Related to Our Business and Our Industry

Our limited operating history makes it difficult to evaluate our current business and future prospects, and may increase the risk of your investment.

We were founded in 2005 and shipped our first products in 2007. The majority of our revenue growth has occurred since 2009. Our limited operating history makes it difficult to evaluate our current business and our future prospects, including our ability to plan for and model future growth. We have encountered and will continue to encounter risks and difficulties frequently experienced by rapidly growing companies in constantly evolving industries, including the risks described in this Annual Report on Form 10-K. If we do not address these risks successfully, our business and operating results will be adversely affected, and our stock price could decline. Further, we have limited historical financial data, and we operate in a rapidly evolving market. As such, any predictions about our future revenue and expenses may not be as accurate as they would be if we had a longer operating history or operated in a more predictable market.

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 and processes, our operating results will be adversely affected.

We have experienced rapid growth and increased demand for our products over the last few years. Our employee headcount and number of end-customers have increased significantly, and we expect to continue to grow our headcount significantly over the next year. For example, from the end of fiscal 2012 to the end of fiscal 2013, our headcount increased from more than 750 to1,147 employees, and our number of end-customers increased from approximately 9,000 to over 13,500. The growth and expansion of our business and product and service offerings places a continuous significant strain on our management, operational, and financial resources. As we have grown, we have increasingly managed more complex deployments of our products and services with larger end-customers. 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 improvements to our systems and processes in an efficient or timely manner, and we may discover deficiencies in our existing systems and processes. We have licensed technology from third parties to help us accomplish this objective. We have continued to improve and customize our enterprise resource planning system since its launch in the second quarter of fiscal 2013. We may experience difficulties in managing improvements to our systems and processes or in connection with third-party software, which could disrupt existing customer relationships, cause us to lose customers, limit us to smaller deployments of our products, or increase our technical support costs. Our failure to improve our systems and processes, or their failure to operate in the intended manner, may result in our inability to manage the growth of our business and to accurately forecast our revenue, expenses, and earnings, or to prevent certain losses. In addition, our systems and processes may not prevent or detect all errors, omissions, or fraud. Our productivity and the quality of our products and services may be adversely affected if we do not integrate and train our new employees quickly and effectively. Any future growth would add complexity to our organization and require effective coordination throughout our organization. For example, as a result of growth in our employee headcount, on September 20, 2012, we entered into two lease agreements for an aggregate of approximately 300,000 square feet of space in Santa Clara, California to serve as our new corporate headquarters beginning in November 2013. We expect to incur additional expense in connection with the two new leases and the relocation of our headquarters, and we expect that the relocation could disrupt our operations and distract our management team. In the fourth quarter of fiscal 2013, we entered into a sublease agreement for our existing headquarters beginning in January 2014. Failure to manage any future growth effectively could result in increased costs, negatively impact our end-customers' satisfaction with our products and services, and harm our operating results.

Our operating results are likely to vary significantly from period to period and be unpredictable, which could cause the trading price of our common stock to decline.

Our operating results, in particular, our revenues, gross and operating margins, and operating expenses, have historically varied from period to period, and we expect that this trend will 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;

- the budgeting cycles and purchasing practices of end-customers;
- changes in end-customer, distributor or reseller requirements, or market needs;
- changes in the growth rate of the enterprise network security market;
- 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;
- changes in mix of our products and services including increases in multi-year subscriptions and support and maintenance;
- price competition;
- deferral of orders from end-customers in anticipation of new products or product enhancements announced by us or our competitors;
- our ability to successfully expand our business domestically and internationally;
- our ability to increase the size of our distribution channel;
- decisions by potential end-customers to purchase enterprise network security solutions from larger, more established security vendors or from their primary network equipment vendors;
- changes in end-customer attach rates and renewal rates for our services;
- 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 customers, which could adversely affect their ability to purchase or pay for our products and services, 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 relationship with important channel partners, including as a result of consolidation among distributors and resellers of network 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 existing and future 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;
- the impact on our overall effective tax rate caused by any reorganization in our corporate structure or any changes in our valuation allowance for domestic deferred assets;
- increases or decreases in our expenses caused by fluctuations in foreign currency exchange rates, as an increasing portion of our expenses are incurred and paid in currencies other than the U.S. dollar; and
- general macroeconomic conditions, both domestically and in our foreign markets.

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.

We are involved in litigation in which Juniper alleges that our appliances infringe seven of its patents. If Juniper prevails in the litigation, we could be required to pay substantial damages for past sales of any infringing appliances, enjoined from

manufacturing, using, selling, and importing such appliances if a license or other right to continue selling our appliances is not made available to us, and required to pay substantial ongoing royalties and comply with unfavorable terms if such a license is made available to us.

In December 2011, Juniper filed a lawsuit against us in the United States District Court for the District of Delaware, alleging that our appliances infringe six of its U.S. patents. One or both of Nir Zuk and Yuming Mao are named inventors on each of the patents being asserted against us. Both Mr. Zuk and Mr. Mao were employed by NetScreen Technologies, Inc., which was acquired by Juniper in April 2004. Mr. Zuk left Juniper in 2005 and founded Palo Alto Networks in that same year. Mr. Mao joined Palo Alto Networks in 2006. Juniper seeks preliminary and permanent injunctions against infringement, treble damages, and attorney’s fees. On February 9, 2012, we filed an answer to Juniper’s complaint, which denied that we infringed Juniper’s patents and asserted that Juniper’s patents were invalid.

On February 28, 2012, Juniper filed a motion to strike our defense of invalidity based on the legal doctrine of “assignor estoppel.” Under the doctrine of assignor estoppel, an inventor of a patented invention who assigns the patent to another for value cannot later challenge the validity of the patent. Under some circumstances, courts have held that the doctrine of assignor estoppel applies not only to the assigning inventor but also to a company in privity with the inventor. On March 23, 2012, we filed a brief in opposition to that motion. Juniper filed a brief in response on April 2, 2012. On August 2, 2012, the District Court issued an order granting Juniper’s motion as to one of the patents in suit (the ’634 patent) but denying Juniper’s motion as to the five other patents in suit. Pursuant to the order, we will not be able to argue in the District Court that the ’634 patent is invalid. Under the Court’s order, however, we are not precluded from arguing that our appliances do not infringe the ’634 patent. Juniper may re-assert its position on the doctrine of assignor estoppel as to the other patents in suit at later stages of the proceedings.

On September 4, 2012, Juniper filed a motion to amend its complaint to allege that our appliances infringe two additional U.S. patents (the added patents) but also to withdraw its allegations as to a previously-asserted patent (the withdrawn patent). This amended complaint was officially filed on September 25, 2012, pursuant to a stipulation between the parties. Juniper now alleges that our appliances infringe seven of its patents. On October 12, 2012, we filed an answer to Juniper’s amended complaint, which denied that we infringed Juniper’s patents and asserted that Juniper’s patents were invalid. In light of the District Court’s prior order granting Juniper’s assignor estoppel motion as to one of the patents in suit (the ‘634 patent), we do not intend to argue in the District Court that the ‘634 patent is invalid, and we do not intend to argue in the District Court that one of the two newly-asserted patents (the ‘752 patent) is invalid.

On September 13, 2012, we filed with the U.S. Patent and Trademark Office requests for *inter partes* reexamination of five of the six patents asserted by Juniper in its original complaint. We did not file a request for reexamination on the withdrawn patent. The Patent and Trademark Office has since issued decisions on our requests for reexaminations. On October 19, 2012 and December 3, 2012, the Patent and Trademark Office granted our requests for reexamination as to three patents (the '459, '700 and '634 patents) rejecting a number of the claims asserted in the litigation, and on November 15, 2012 and 26, 2012, the Patent and Trademark Office denied our requests for reexamination as to two other patents (the '723 and '347 patents). We have the opportunity to seek review of these denials within the Patent and Trademark Office, and have done so with respect to one of the patents (the '723 patent). On June 20, 2013 and July 23, 2013, we filed with the U.S. Patent and Trademark Office petitions for *inter partes* review for two other patents asserted by Juniper in the litigation (the '612 and '752 patents). The Patent and Trademark Office has not yet ruled on those petitions. Should any claim challenged in our reexamination requests be finally determined to be valid and patentable, we may be precluded in litigation from challenging any such patent claim on invalidity grounds that were or could have been raised during the *inter partes* reexamination proceedings.

The judge has issued a scheduling order which sets forth the current expectation for important events in the lawsuit, although no assurances can be given that the schedule will not change. On June 18, 2012 and on October 12, 2012, Juniper served infringement contentions, which, among other things, assert that each of our products that run our PAN-OS operating system infringes each of the Juniper patents-in-suit. We served our invalidity contentions on Juniper on July 18, 2012 and, for the newly-asserted patents, on November 19, 2012. Each party served its opening expert report on April 12, 2013, and rebuttal expert report on May 13, 2013, and supplemental expert reports on June 11, 2013. The parties filed opening and responsive briefs regarding claim construction (also known as Markman), filed their opening summary judgment briefs on August 20, 2013, and filed opposition briefs and additional summary judgment motions on September 12, 2013. A hearing to resolve claim construction issues, as well as motions for summary judgment, is scheduled to be heard on November 15, 2013, and a trial date has been scheduled for February 24, 2014. Pursuant to the Court’s general standing order, the February 2014 trial will be limited to determining whether the patents (other than the ’634 and ’752 patents) are valid and whether we infringe one or more valid patents. Thereafter, the Court will rule on any post-trial motions and enter a judgment on validity and infringement. According to the Court’s general standing order, if Juniper were to prevail on one or more of its patents, a subsequent trial on damages would be scheduled following an appeal on the liability issues to the appellate court.

Should Juniper prevail on its claims that one or more of our appliances infringe one or more of its valid patents, we could be required to pay substantial damages for past sales of such appliances, enjoined from manufacturing, using, selling, and importing such appliances if a license or other right to continue selling our appliances is not made available to us, and required to pay substantial ongoing royalties and comply with unfavorable terms if such a license is made available to us. Any of these outcomes could result in a material adverse effect on our business. Even if we were to prevail, this litigation will be costly and time-consuming, divert the attention of our management and key personnel from our business operations, deter distributors from selling our appliances, and dissuade potential end-customers from purchasing our appliances, which would also materially harm our business. During the course of litigation, we anticipate announcements of the results of hearings and motions, and other interim developments related to the litigation. If securities analysts or investors regard these announcements as negative, the market price of our common stock may decline.

We are vigorously defending the lawsuit. At this stage in the litigation, we are unable to predict the likelihood of success of Juniper’s infringement claims.

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

You should not consider our revenue growth rate in recent periods as indicative of our future performance. We have recently experienced revenue growth rates of 55% and 115% in fiscal 2013 and 2012, respectively. We do not expect to achieve similar revenue growth rates in future periods. You should not rely on our revenue for any prior quarterly or annual periods as any indication of our future revenue or revenue growth. If we are unable to maintain consistent revenue or revenue growth, our stock price could be volatile, and it may be difficult to achieve and maintain profitability.

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

Other than fiscal 2012, we have incurred losses in all fiscal years since our inception. We incurred a net loss of $29.2 million in fiscal 2013, $12.5 million in fiscal 2011, and $21.1 million in fiscal 2010. As a result, we had an accumulated deficit of $109.3 million at July 31, 2013. We anticipate that our operating expenses will increase substantially in the foreseeable future as we continue to enhance our product and service offerings, broaden our end-customer base, expand our sales channels, expand our operations, hire additional employees, and continue to develop our technology. These efforts may prove more expensive than we currently anticipate, and we may not succeed in increasing our revenues sufficiently, or at all, to offset these higher expenses. Revenue growth may slow or revenue may decline for a number of possible reasons, including slowing demand for our products or services, increasing competition, a decrease in the growth of our overall market, or a failure to capitalize on growth opportunities. Any failure to increase our revenues as we grow our business could prevent us from maintaining or increasing profitability or cash flow on a consistent basis. If we are unable to meet these risks and challenges as we encounter them, our business, financial condition, and operating results may suffer.

If we are unable to sell additional products and services 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 by selling additional products to secure other areas of our end-customers’ network and by upselling additional subscription services to provide increasing levels of network security. This may require increasingly sophisticated and costly sales efforts and may not result in additional sales. In addition, the rate at which our end-customers purchase additional products and services depends on a number of factors, including the perceived need for additional network security products and services as well as general economic conditions. If our efforts to sell additional products and services to our end-customers are not successful, our business may suffer.

Further, existing end-customers that purchase our subscriptions have no contractual obligation to renew their contracts after the initial contract period, which is typically one year, and we cannot accurately predict renewal rates. Our end-customers’ renewal rates may decline or fluctuate as a result of a number of factors, including their satisfaction with our services and our end-customer support, the frequency and severity of subscription outages, our product uptime or latency, and the pricing of our, or competing, services. If our end-customers renew their subscriptions, they may renew for shorter contract lengths or on other terms that are less economically beneficial to us. We have limited historical data with respect to rates of end-customer renewals, so we may not accurately predict future renewal trends. We cannot assure you that our end-customers will renew their subscriptions, and if our end-customers do not renew their agreements or renew on less favorable terms, our revenues may grow more slowly than expected or decline.

We also depend on our installed end-customer base for future support and maintenance revenues. Our support and maintenance agreements are typically one year. If end-customers choose not to continue renewing their support and maintenance or seek to renegotiate the terms of support and maintenance agreements prior to renewing such agreements, our revenue may 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 network security products is intensely competitive, and we expect competition to increase in the future from established competitors and new market entrants. Our current competitors include networking companies such as Cisco Systems, Inc. and Juniper, large companies, such as Intel Corporation, International Business Machines (IBM), and Hewlett-Packard (HP) that have acquired large network security vendors in recent years, security vendors such as Check Point Software Technologies, Ltd. and Fortinet, Inc., and other point solution security vendors. New, privately held companies, as well as established public companies, are currently attempting to enter this market, some of which may become significant competitors in the future. 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 acquisitions;
- 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 offerings and 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, including through selling at zero or negative margins, product bundling, or closed technology platforms. Potential end-customers may also prefer to purchase from their existing suppliers rather than a new supplier regardless of product performance or features. These larger competitors often have broader product lines and market focus and may therefore not be as susceptible to downturns in a particular market. Many of our smaller competitors that specialize in providing protection from a single type of network security threat are often able to deliver these specialized network security products to the market more quickly than we can. Conditions in our market could change rapidly and significantly as a result of technological advancements, partnering 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 technology. Our current and potential competitors may also establish cooperative relationships among themselves or with third parties that may further enhance their resources.

Some of our competitors have made acquisitions of businesses that may allow them to offer more directly competitive and comprehensive solutions than they had previously offered, such as Intel's acquisition of McAfee and Stonesoft, Check Point's acquisition of Nokia's security appliance business, and Cisco's pending acquisition of SourceFire. As a result of such acquisitions, our current or potential competitors might be able to adapt more quickly to new technologies and end-customer needs, devote greater resources to the promotion or sale of their products and services, initiate or withstand substantial price competition, take advantage of acquisition or other opportunities more readily, or develop and expand their product and service offerings more quickly than we do. Due to various reasons, organizations may be more willing to incrementally add solutions to their existing network security infrastructure from competitors than to replace it with our solutions. 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.

If functionality similar to that offered by our products is incorporated into existing network infrastructure products, organizations may decide against adding our appliances to their network, which would have an adverse effect on our business.

Large, well-established providers of networking equipment such as Cisco and Juniper offer, and may continue to introduce, network security features that compete with our products, either in stand-alone security products or as additional features in their network infrastructure products. The inclusion of, or the announcement of an intent to include, functionality perceived to be similar to that offered by our security solutions in networking products that are already generally accepted as necessary components of network architecture may have an adverse effect on our ability to market and sell our products. Furthermore, even if the functionality offered by network infrastructure providers is more limited than our products, a significant number of end-customers may elect to accept such limited functionality in lieu of adding appliances from an additional vendor such as us. 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 products, which may make them reluctant to add new components to their networks, particularly from other vendors such as us. In addition, an organization's existing vendors or new vendors with a broad product offering may be able to offer concessions that we are not able to match because we currently offer only network security products and have fewer resources than many of our competitors. If organizations are reluctant to add additional network infrastructure from new vendors or otherwise decide to work with their existing vendors, our ability to increase our market share and improve our financial condition and operating results will be adversely affected.

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, 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, our inability to release new products on schedule, any failure of our systems related to order review and processing, or any delays in shipments based on trade compliance requirements, our revenue for that quarter could fall below our expectations, resulting in a decline in the trading price of our common stock.

If we are unable to hire, retain, train, and motivate qualified personnel and senior management, our business could suffer.

Our future success depends, in part, on our ability to continue to attract and retain highly skilled personnel. The loss of the services of any of our key personnel, the inability to attract or retain qualified personnel, or delays in hiring required personnel, particularly in engineering and sales, may seriously harm our business, financial condition, and operating results. Although we have entered into employment offer letters with our key personnel, these agreements have no specific duration and constitute at-will employment. We are also substantially dependent on the continued service of our existing development personnel because of the complexity of our platform. Additionally, any failure to hire, train, and adequately incentivize our sales personnel could negatively impact our growth. Further, the inability of our recently hired sales personnel to effectively ramp to target productivity levels could negatively impact our operating margins. If we are not effective in managing the leadership transition in our sales organization, our business could be adversely impacted and our operating results and financial condition could be harmed.

Competition for highly skilled personnel is often intense, especially in the San Francisco Bay Area where we have a substantial presence and need for highly skilled personnel. We may not be successful in attracting, integrating, or retaining qualified personnel to fulfill our current or future needs. Also, to the extent we hire personnel from competitors, we may be subject to allegations that they have been improperly solicited, or that they have divulged proprietary or other confidential information, or that their former employers own their inventions or other work product.

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 could significantly delay or prevent the achievement of our development and strategic objectives, which could adversely affect our business, financial condition, and operating results.

Our employees do not have employment arrangements that require them to continue to work for us for any specified period, and therefore, they could terminate their employment with us at any time. We do not maintain key person life insurance policies on any of our employees. The loss of one or more of our key employees or groups could seriously harm our business.

We rely on third-party channel partners to sell substantially all of our products, and if our partners fail to perform, our ability to sell and distribute our products and services 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 sales channel partners with specific training and programs to assist them in selling our products, but there can be no assurance that these steps will be effective. In addition, our channel partners may be unsuccessful in marketing, selling, and supporting our products and services. If we are unable to develop and maintain effective sales incentive programs for our third-party channel partners, we may not be able to incentivize these partners to sell our products to end-customers and, in particular, to large enterprises. These partners may also market, sell, and support products and services that are competitive with ours and may devote more resources to the marketing, sales, and support of such competitive products. These partners may have incentives to promote our competitors' products to the detriment of our own or may cease selling our products altogether. 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 assure you that we will retain these channel partners or that we will be able to secure additional or replacement channel partners. The loss of one or more of our significant channel partners or a decline in the number or size of orders from them could harm our operating results. In addition, any new sales 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 services to end-customers or violate laws or our corporate policies. If we fail to effectively manage our existing sales channels, or if our channel partners are unsuccessful in fulfilling the orders for our products, or if we are unable to enter into arrangements with, and retain a sufficient number of, high quality channel partners in each of the regions in which we sell products and keep them motivated to sell our products, our ability to sell our products and operating results will be harmed.

Because we depend on third-party manufacturers 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 customers.

We depend on third-party manufacturers, primarily Flextronics International Ltd., our contract manufacturer, as sole source manufacturers for our product lines. Our reliance on these third-party manufacturers reduces our control over the manufacturing process and exposes us to risks, including reduced control over quality assurance, product costs, and product supply and timing, as well as the risk that minerals which originate from the Democratic Republic of the Congo and adjoining countries, or conflicts minerals, may be included in our products. Any manufacturing and logistics disruption by these third-party manufacturers could severely impair our ability to fulfill orders. In addition, we are subject to new requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act that will require us to diligence, disclose and report whether or not our products contain conflicts minerals. The implementation of these new 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. In addition, we will incur additional costs to comply with the disclosure requirements, including costs related to determining the source of any of the relevant minerals and metals used in our products.

These manufacturers typically fulfill our supply requirements on the basis of individual orders. We do not have long term contracts with our third-party 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, which could result in supply shortages, and the prices we are charged for manufacturing services could be increased on short notice. Our contract with one of our contract manufacturers permits them to terminate the agreement for their convenience, subject to prior notice requirements. If we are required to change contract manufacturers, our ability to meet our scheduled product deliveries to our customers could be adversely affected, which could cause the loss of sales to existing or potential 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 third-party manufacturers 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 marketing 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. Supply management remains an increased area of focus as we balance the need to maintain supply levels that are sufficient to ensure competitive lead times against the risk of obsolescence because of rapidly changing technology and end-customer requirements. 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 contract manufacturer, we accrue for losses on manufacturing commitments in excess of forecasted demand. Alternatively, insufficient supply levels may lead to shortages that result in delayed revenue or loss of sales opportunities altogether as potential end-customers turn to competitors' products that are readily available. Additionally, any increases in the time required to manufacture our products or ship products could result in supply shortfalls. 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 customers and may result in the loss of sales and customers.

Our products rely on key components, including integrated circuit components, which our contract manufacturers purchase on our behalf from a limited number of 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. A fire, flood, earthquake, tsunami or other disaster, condition or event such as political instability, civil unrest or a power outage that adversely affects any of these component suppliers' facilities could significantly affect our ability to obtain the necessary components for our products, which could result in a substantial loss of sales and revenue and a substantial harm to our operating results. Similarly, a localized health risk affecting employees at these facilities, such as the spread of a pandemic influenza, could impair the total volume of components that we are able to obtain, which could result in substantial harm to our operating results.

We do not have volume purchase contracts with any of our component suppliers, and they could cease selling to us at any time. In addition, our component suppliers change their selling prices frequently in response to market trends, including industry-wide increases in demand, and because we do not have contracts with these suppliers, we are susceptible to price fluctuations related to raw materials and components. If we are unable to pass component price increases along to our customers or maintain stable pricing, our gross margins and operating results could be negatively impacted. 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, which would negatively impact our revenue and gross margins. Additionally, poor quality in any of the sole-sourced components in our products could result in lost sales or lost sales opportunities. If the quality of the components does not meet our or our end-customers' requirements, if we are unable to obtain components from our existing suppliers on commercially reasonable terms, or if any of our sole source providers cease to remain in business or continue to manufacture such components, we could be forced to redesign our products and qualify new components from alternate 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.

If we are not successful in executing our strategy to increase sales of our products 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 medium and large enterprises. Sales to these types of 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 service contracts, including stricter support response times and penalties for any failure to meet support requirements; and
- longer sales cycles 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 services.

Large enterprises often undertake a significant evaluation process that results in a lengthy sales cycle, in some cases over 12 months. Although we have a channel sales model, our sales representatives typically engage in direct interaction with our distributors and resellers in connection with sales to larger end-customers. Because these evaluations are often lengthy, with significant size and scope and stringent requirements, we typically provide evaluation products to these end-customers. We may spend substantial time, effort, and money in our sales efforts without being successful in generating any sales. 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 services which may decline, and because we recognize revenue from subscriptions and support services over the term of the relevant service period, downturns or upturns in sales are not immediately reflected in full in our operating results.

Services revenue accounts for a significant portion of our revenue, comprising 38% of total revenue in fiscal 2013, 32% of total revenue in fiscal 2012, and 28% of total revenue for fiscal 2011. Sales of new or renewal subscription and support and maintenance contracts may decline and fluctuate as a result of a number of factors, including end-customers' level of satisfaction with our products and services, the prices of our products and services, 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 and maintenance contracts decline, our revenue and revenue growth may decline and our business will suffer. In addition, we recognize subscription and support and maintenance revenue monthly over the term of the relevant service period, which is typically one year and can be up to five years. As a result, much of the subscription and support and maintenance revenue we report each fiscal quarter is the recognition of deferred revenue from subscription and support and maintenance contracts entered into during previous fiscal quarters. Consequently, a decline in new or renewed subscription or support and maintenance contracts in any one fiscal quarter will not be fully reflected in revenue in that fiscal quarter but will negatively affect our revenue in future fiscal quarters. Accordingly, the effect of significant downturns in new or renewed sales of our subscriptions or support and maintenance is not reflected in full in our operating results until future periods. Also, it is difficult for us to rapidly increase our services revenue through additional service sales in any period, as revenue from new and renewal service contracts must be recognized over the applicable service period. Furthermore, any increase in the average term of services contracts would result in revenue for services contracts being recognized over longer periods of time.

Defects, errors, or vulnerabilities in our products or services or the failure of our products or services to block a virus or prevent a security breach could harm our reputation and adversely impact our results of operations.

Because our products and services 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 that were not detected before shipping the product. Additionally, defects may cause our products or services 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 network security solutions, our networks, products, and services 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 services to effectively update end-customers' hardware products and thereby leave our end-customers vulnerable to attacks. 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 end-customer base, any of which could temporarily or permanently expose our end-customers' networks, leaving their networks unprotected against the latest security threats.

Any defects, errors or vulnerabilities in our products 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.

Our business is subject to the risks of warranty claims, product returns, product liability, and product defects.

Our products are very complex and, despite testing prior to their release, they have contained and may contain undetected defects or errors, especially when first introduced or when new versions are released. Product defects or errors could affect the performance of our products and could delay the development or release of new products or new versions of products, adversely affect our reputation and our end-customers' willingness to buy products from us, and adversely affect market acceptance or perception of our products. Any such errors or delays in releasing new products or new versions of products or allegations of unsatisfactory performance could cause us to lose revenue or market share, increase our service costs, cause us to incur substantial costs in redesigning the products, cause us to lose significant end-customers, subject us to liability for damages and divert our resources from other tasks, any one of which could materially and adversely affect our business, results of operations and financial condition. Our products must successfully interoperate with products from other vendors. As a result, when problems occur in a network, it may be difficult to identify the sources of these problems. For example, from time to time certain of our end-customers have experienced temporary delays or interoperability issues when implementing our products in large complex global deployments where our products are required to interoperate with a complex environment of third party products. The occurrence of hardware or software errors, whether or not caused by our products, could delay or reduce market acceptance of our products, and have an adverse effect on our business and financial performance, and any necessary revisions may cause us to incur significant expenses. The occurrence of any such problems could harm our business, financial condition and results of operations.

Although we have limitation of liability provisions in our standard terms and conditions of sale, they 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 also entails the risk of product liability claims. Although we may be indemnified by our manufacturers for product liability claims arising out of manufacturing defects, because we control the design of our products, 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, 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.

If the network security market does not continue to adopt our network security platform, our sales will not grow as quickly as anticipated, and our stock price could decline.

We are seeking to disrupt the network security market with our network security platform. However, organizations that use legacy products and services for their network security needs may believe that these products and services sufficiently achieve their purpose. Organizations may also believe that our products and services only serve the needs of a portion of the network security market. Accordingly, organizations may continue allocating their IT budgets for legacy products and services and may not adopt our network security platform. If the market for network security solutions does not continue to adopt our network security platform, if end-customers do not recognize the value of our platform compared to legacy products and services, or if we are otherwise unable to sell our products and services to organizations, then our revenue may not grow or may decline, which would have a material adverse effect on our operating results and financial condition.

If we do not accurately predict, prepare for, and respond promptly to the rapidly evolving technological and market developments and changing end-customer needs in the network security market, our competitive position and prospects will be harmed.

The network security market 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. The technology in our products 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 products and enhancements may require us to develop new hardware architectures that involve complex, expensive, and time-consuming research and development processes. Although the market expects rapid introduction of new products or product enhancements to respond to new threats, the development of these products 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 products. We may experience unanticipated delays in the availability of new products and services and fail to meet customer expectations for such availability. If we do not quickly respond to the rapidly changing and rigorous needs of our end-customers by developing, releasing, and making available on a timely basis new products and services or enhancements that can respond adequately to new security threats, our competitive position and business prospects will be harmed.

Additionally, the process of developing new technology is complex and uncertain, and if we fail to accurately predict end-customers' changing needs and emerging technological trends in the network security industry, including the areas of mobility, virtualization, cloud computing and software defined networks (SDN), our business could be harmed. We must commit significant resources to developing new products before knowing whether our investments will result in products the market will accept. The success of new products depends on several factors, including appropriate new product definition, component costs, timely completion and introduction of these products, differentiation of new products from those of our competitors, and market acceptance of these products. There can be no assurance that we will successfully identify new product opportunities, develop and bring new products to market in a timely manner, or achieve market acceptance of our products, or that products and technologies developed by others will not render our products or technologies obsolete or noncompetitive.

Our current research and development efforts may not produce successful products or features that result in significant revenue, cost savings or other benefits in the near future, if at all.

Developing our products and related enhancements is expensive. Our investments in research and development may not result in significant design improvements, marketable products or features or may result in products 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 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.

The sales prices of our products and services may decrease, which may reduce our gross profits and adversely impact our financial results.

The sales prices for our products and services may decline for a variety of reasons, including competitive pricing pressures, discounts, a change in our mix of products and services, anticipation of the introduction of new products or services, 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 services that compete with ours or may bundle them with other products and services. Additionally, although we price our products and services worldwide in U.S. dollars, currency fluctuations in certain countries and regions may negatively impact actual prices that 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 assure you that we will be successful in developing and introducing new offerings with enhanced functionality on a timely basis, or that our product and service 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 services internationally. As a result, we must hire and train experienced personnel to staff and manage our foreign operations. To the extent that we experience difficulties in recruiting, training, managing, and retaining an international staff, and specifically staff related to sales management and sales personnel, we may experience difficulties in sales productivity in foreign markets. We also enter into strategic distributor and reseller relationships with companies in certain international markets where we do not have a local presence. If we are not able to maintain successful strategic distributor relationships internationally or recruit additional companies to enter into strategic distributor relationships, our future success in these international markets could be limited. 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 in customer contracts, although to date we generally have not done so. To the extent that we may enter into customer contracts in the future that include non-standard terms related to payment, warranties, or performance obligations, our operating results may be adversely impacted.

Additionally, our international sales and operations are subject to a number of risks, including the following:

- economic uncertainty around the world, in particular, macroeconomic challenges in Europe;
- 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 regulatory practices, tariffs, and tax laws and treaties;
- 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, partners, distributors, and resellers to comply with both U.S. and foreign laws, including antitrust regulations, the U.S. Foreign Corrupt Practices Act, and any trade regulations ensuring fair trade practices;
- heightened risk of unfair or corrupt business practices in certain geographies and of improper or fraudulent sales arrangements that may impact financial results and result in restatements of, or irregularities in, financial statements;
- increased expenses incurred in establishing and maintaining office space and equipment for our international operations;
- greater difficulty in recruiting local experienced personnel, and the costs and expenses associated with such activities;
- management communication and integration problems resulting from cultural and geographic dispersion;
- fluctuations in exchange rates between the U.S. dollar and foreign currencies in markets where we do business; and
- general economic and political conditions in these foreign markets.

These factors 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.

We are exposed to the credit and liquidity risk of some of our channel partners and to credit exposure in weakened markets, which could result in material losses.

For fiscal 2013, three channel partners represented 64% of our total revenue, and as of July 31, 2013, four channel partners represented 76% 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 assure you 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 U.S. and foreign, federal, state, and local governmental agency end-customers have accounted for an increasingly significant amount of our revenue, and we may in the future increase sales to government entities. 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. Government certification requirements for products like ours may change, thereby restricting our ability to sell into the federal government sector until we have attained the revised certification. Government demand and payment for our products and services may be impacted by public sector budgetary cycles and funding authorizations, with funding reductions or delays adversely affecting public sector demand for our products and services.

The substantial majority of our sales to date to government entities have been made indirectly through our channel partners. 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 services, a reduction of revenue or fines or civil or criminal liability if the audit uncovers improper or illegal activities, which could adversely impact our operating results in a material way. Finally, for purchases by the U.S. government, the government may require certain products to be manufactured in the United States and other relatively high cost manufacturing locations, and we may not manufacture all products in locations that meet the requirements of the U.S. government, affecting our ability to sell these products to the U.S. government.

Sequestration or other actions of the U.S. Government resulting in significant cuts in U.S. Government spending could adversely affect our sales and future results.

The Budget Control Act of 2011 (Budget Control Act), which raised the U.S. national debt ceiling and put into effect a series of actions for deficit reduction, triggered automatic reductions in U.S. Government spending, known as "sequestration," beginning in 2013. While Congress and the Administration continue to debate how the nation should proceed on these issues, the outcome of that debate could have a significant impact on future U.S. Government spending plans, including the overall spending on network security by the various agencies of the U.S. Government. Our sales and future results may be adversely impacted by reductions in U.S. Government spending as a result of sequestration.

If our products do not interoperate with our end-customers' infrastructure, sales of our products and services could be negatively affected, which would harm our business.

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. If we find defects in the hardware, we replace the hardware as part of our normal warranty process. If we find errors in the existing software that create problematic network configurations or settings, as we have in the past, we may have to issue software updates as part of our normal maintenance process. Any delays in identifying the sources of problems or in providing necessary modifications to our software or hardware could have a negative impact on our reputation and our end-customers' satisfaction with our products and services, and our ability to sell products and services could be adversely affected. In addition, government and other end-customers may require our products to comply with certain security or other certifications and standards. If our products 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 to such end-customers, or at a competitive disadvantage, which would harm our business, operating results, and financial condition.

Our ability to sell our products is dependent on the quality of our and our channel partners' technical support services, and our or our channel partners' failure to offer high quality technical support services could have a material adverse effect on our end-customers' satisfaction with our products and services, our sales, and our operating results.

Once our products 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. If we or our channel partners do not effectively assist our end-customers in deploying our products, succeed in helping our end-customers quickly resolve post-deployment issues, or provide effective ongoing support, our ability to sell additional products and services 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 the 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 when the sales of our products exceed our internal forecasts. To the extent that we or our partners are unsuccessful in hiring, training, and retaining adequate support resources, our and our channel partners' ability to provide adequate and timely support to our end-customers will be negatively impacted, and our end-customers' satisfaction with our products and services will be adversely affected. Additionally, to the extent that we may need to rely on our sales engineers to provide post-sales support while we are ramping our support resources, our sales productivity will be negatively impacted, which would harm our revenues. Our or our channel partners failure to provide and maintain high quality support services would have a material adverse effect on our business, financial condition, and operating results.

False detection of applications, viruses, spyware, vulnerability exploits, data patterns or URL categories could adversely affect our business.

Our classifications of application type, virus, spyware, vulnerability exploits, data, or URL categories may falsely detect applications, content, or threats that do not actually exist. This risk is heightened by the inclusion of a "heuristics" feature in our products, 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, while typical in our industry, may impair the perceived reliability of our products and may therefore adversely impact market acceptance of our products. If our products 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 end-customers and sales, increased costs to remedy any problem, and costly litigation.

Claims by others that we infringe their proprietary technology or other rights could harm our business.

Companies in the enterprise network 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. As we face increasing competition and gain an increasingly high profile, the possibility of intellectual property rights claims against us grows. Third parties have asserted and may in the future assert claims of infringement of intellectual property rights against us. For example, beginning in January 2009, Fortinet, Inc. began filing a series of complaints against us alleging, among other claims, patent infringement. We entered into a settlement agreement with Fortinet, Inc. in January 2011 which included a three-year covenant by each party not to sue the other party for patent related claims. This covenant not to sue expires in January 2014. 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 infringe the intellectual property rights of third parties. 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, future 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. Refer to the discussion under "Legal Proceedings" included in Part I, Item 3 of this Annual Report on Form 10-K for information related to pending litigation.

Although third parties may offer a license to their technology or other intellectual property, the terms of any offered license may not be acceptable and the failure to obtain a license or the costs associated with any license could cause our business, financial condition, and operating results to be materially and adversely affected. In addition, some licenses may be non-exclusive, and therefore our competitors may have access to the same technology licensed to us. If a third party does not offer us a license to its technology or other intellectual property on reasonable terms, or at all, we could be enjoined from continued use of such intellectual property. As a result, we may be required to develop alternative, non-infringing technology, which could require significant time (during which we would be unable to continue to offer our affected products or services), effort, and expense and may ultimately not be successful. Furthermore, 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 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. 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. Patent applications in the United States are typically not published until 18 months after filing, or, in some cases, not at all, and publications of discoveries in industry-related literature lag behind actual discoveries. 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. In addition, recent changes to the patent laws in the United States may bring into question the validity of certain categories of software patents. 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 obtain and use information that we regard as proprietary. We generally enter into confidentiality or license agreements with our employees, consultants, vendors, and customers, and generally limit access to and distribution of our proprietary information. However, we cannot assure you 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 could negatively affect our ability to sell our products and subject us to possible litigation.

Our products contain software modules licensed to us by third-party authors under “open source” licenses. Some open source licenses contain requirements that we make available 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 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 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. From time to time, there have been claims against companies that distribute or use open source software in their products and services, 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. Moreover, we cannot assure you that our processes for controlling our use of open source software in our products will be effective. 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 on terms that are not economically feasible, to re-engineer our products, to discontinue the sale of our products 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 all open source software is submitted for approval prior to use in our products.

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 may result in ever-increasing regulatory and public scrutiny and escalating levels of enforcement and sanctions. Our failure to comply with applicable laws and regulations, or to protect such 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 European Union, the United States, and elsewhere, especially relating to classification of IP addresses, machine identification, location data, and other information, may limit or inhibit our ability to operate or expand our business, including limiting strategic partnerships that may involve the sharing of data. Even the perception of privacy concerns, whether or not valid, may harm our reputation and inhibit adoption of our products by current and future end-customers.

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 services. 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. 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 services containing that 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 of lower quality or performance standards. This would limit and delay our ability to offer new or competitive products and services and increase our costs of production. As a result, our margins, market share, and operating results could be significantly harmed.

Misuse of our products could harm our reputation and divert resources.

Our products may be misused by end-customers or third parties that obtain access to our products. For example, our products could be used to censor private access to certain information on the Internet. Such use of our products for censorship could result in negative press coverage and negatively affect our reputation.

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 U.S. 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, 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 or sell our products would likely adversely affect our business, financial condition, and operating results.

Our corporate culture has contributed to our success, and if we cannot maintain this culture as we grow, we could lose the innovation, creativity, and teamwork fostered by our culture, and our business may be harmed.

We believe that a critical contributor to our success has been our corporate culture, which we believe fosters innovation, teamwork, passion for customers, and focus on execution, as well as facilitating 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, which could limit our ability to innovate and operate effectively. Any failure to preserve our culture could also negatively affect our ability to retain and recruit personnel, continue to perform at current levels or execute on our business strategy.

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 make investments in complementary companies, products, or technologies. However, we have not made any significant acquisitions to date, and as a result, our ability as an organization to acquire and integrate other companies, products or technologies in a successful manner is unproven. We may not be able to find suitable acquisition candidates, and we may not be able to complete such acquisitions on favorable terms, if at all. If we do complete acquisitions, we may not ultimately strengthen our competitive position or achieve our goals, 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 such acquisitions, or the technologies associated with such acquisitions, into our company, the revenue and operating results of the combined company could be adversely affected. Any integration process may require significant time and resources, and we may not be able to manage the process successfully. We may not successfully evaluate or utilize the acquired technology or personnel, or accurately forecast the financial impact of an acquisition transaction, including accounting charges. We may have to pay cash, incur debt or issue equity securities to pay for any such acquisition, each of which could adversely affect our financial condition or the value of our common stock. The sale of equity or issuance of debt to finance any such acquisitions could result in dilution to our stockholders. The incurrence of indebtedness would result in increased fixed obligations and could also include covenants or other restrictions that would impede our ability to manage our operations.

Our failure to raise additional capital or generate the significant capital necessary to expand our operations and invest in new products 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 financing, our stockholders may experience significant dilution of their ownership interests and the per share value of our common stock could decline. Furthermore, if we engage in debt financing, the holders of debt would have priority over the holders of 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 force 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 may not be able to successfully manage the growth of our business if we are unable to improve our internal systems, processes, and controls.

We need to continue to improve our internal systems, processes, and controls to effectively manage our operations and growth. We may not be able to successfully implement improvements to these systems, processes, and controls in an efficient or timely manner. We have implemented a new enterprise resource planning system, and we may not be able to successfully scale improvements to our enterprise resource planning system or implement and scale other systems and processes in a timely or efficient manner or in a manner that does not negatively affect our operating results. In addition, our systems and processes may not prevent or detect all errors, omissions, or fraud. We have licensed technology from third parties to help us improve our internal systems, processes, and controls. The support services available for such third-party technology may be negatively affected by mergers and consolidation in the software industry, and support services for such technology may not be available to us in the future. We may experience difficulties in managing improvements to our systems, processes, and controls or in connection with third-party software, which could impair our ability to provide products or services to our customers in a timely manner, causing us to lose customers, limit us to smaller deployments of our products, or increase our technical support costs.

We recently implemented a corporate structure more closely 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 results of operations could be adversely affected.

We recently 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 will 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 taxing authorities, changes in domestic and international tax laws negatively impact the structure, including proposed legislation to reform U.S. taxation of international business activities, or we do not operate our business consistent with the structure and applicable tax provisions, we may fail to achieve the financial and operational efficiencies that we anticipate as a result of the structure and our future financial condition and results of operations may be negatively impacted.

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 expectations of securities analysts and investors, resulting in a decline in our stock price.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the 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, as provided in the section entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” 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. Our operating results may be adversely affected if our assumptions change or if actual circumstances differ from those in our assumptions, which could cause our operating results to fall below the expectations of securities analysts and investors, resulting in a decline in our stock price. Significant assumptions and estimates used in preparing our consolidated financial statements include those related to revenue recognition, share-based compensation, contract manufacturing liabilities, warranties, loss contingencies, and income taxes.

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, 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 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 European Union, or EU, Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment Directive, or RoHS, and the EU Waste Electrical and Electronic Equipment Directive, or WEEE, as well as the implementing legislation of the EU 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 EU RoHS and the similar laws of other jurisdictions ban the use of certain hazardous materials such as lead, mercury, and cadmium in the manufacture of electrical equipment, including our products. Currently, the manufacturer of our hardware appliances and major component part suppliers comply with the EU 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.

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 results of operations 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.

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, a strengthening of the U.S. dollar could increase the real cost of our products to our end-customers outside of the United States, which could adversely affect our financial condition and operating results. In addition, an increasing portion of our operating expenses is incurred outside the United States, is denominated in foreign currencies, and is subject to fluctuations due to changes in foreign currency exchange rates. If we are not able to successfully hedge against the risks associated with currency fluctuations, our financial condition and operating results could be adversely affected.

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.

A significant natural disaster, such as an earthquake, fire, a flood, or significant power outage could have a material adverse impact on our business, operating results, and financial condition. 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, natural disasters could affect our supply chain, manufacturing vendors, or logistics providers' ability to provide materials and perform services such as manufacturing products or assisting with shipments on a timely basis. In the event our or our service providers' information technology systems or manufacturing or logistics abilities are hindered by any of the events discussed above, shipments could be delayed, resulting in missed financial targets, such as revenue and shipment targets, for a particular quarter. In addition, acts of terrorism and other geo-political unrest could cause disruptions in our business or the business of our supply chain, manufacturers, logistics providers, partners, or end-customers or the economy as a whole. Any disruption in the business of our supply chain, manufacturers, logistics providers, partners, or end-customers that impacts sales at the end of a fiscal quarter could have a significant adverse impact on our quarterly results. All of the aforementioned 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, 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 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 call, 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. We intend to state possible outcomes as high and low ranges which are intended to provide a sensitivity analysis as variables are changed but are not intended to imply that actual results could not fall outside of the suggested ranges. The principal reason that we release guidance is to provide a basis for our management to discuss our business outlook with analysts and investors. We do not accept any responsibility for any projections or reports published by any such persons.

Guidance is necessarily speculative in nature, and it can be expected that some or all of the assumptions underlying the guidance furnished by us will not materialize or will vary significantly from actual results. Accordingly, our guidance is only an estimate of what management believes is realizable as of the date of release. Actual results will vary from our guidance and the variations may be material. In light of the foregoing, 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 could result in the actual operating results being different from our guidance, and the differences may be adverse and material.

The price of our common stock may be volatile and the value of your investment could decline.

The trading 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 $72.61 to $39.08, through September 10, 2013. The trading 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, services or technologies, commercial relationships, acquisitions or other events by us or our competitors;
- price and volume fluctuations in the overall stock market from time to time;
- 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;
- litigation involving us, our industry, or both, including any developments with respect to our pending litigation, described under the "Litigation" subheading in Note 6. Commitments and Contingencies of Notes to Consolidated Financial Statements in Part II, Item 8 of this Quarterly Report on Form 10-Q;
- regulatory developments in the United States, foreign countries or both;
- major catastrophic events;
- sales of large blocks of our stock;
- departures of key personnel; or
- economic uncertainty around the world, in particular, macroeconomic challenges in Europe;

In addition, if the market for technology stocks or the stock market in general experiences loss of investor confidence, the trading price of our common stock could decline for reasons unrelated to our business, operating results or financial condition. The trading price of our common stock might also decline in reaction to events that affect other companies in our industry even if these events 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.

Substantial future sales of shares of our common stock could cause the market price of our common stock to decline.

The market price of shares of our common stock could decline as a result of substantial sales of our common stock, particularly sales by our directors, executive officers, employees and significant stockholders, a large number of shares of our common stock becoming available for sale, or the perception in the market that holders of a large number of shares intend to sell their shares. As of July 31, 2013, we had outstanding approximately 71,612,000 shares of our common stock.

As of July 31, 2013, certain holders of our common stock have rights, subject to some conditions, to require us to file registration statements covering their shares or to include their shares in registration statements that we may file for our stockholders or ourselves. We have also registered shares of common stock that we may issue under our employee equity incentive plans. These shares will be able to be sold freely in the public market upon issuance.

The issuance of additional stock in connection with financings, acquisitions, investments, our stock incentive plans or otherwise will dilute all other stockholders.

Our amended and restated certificate of incorporation authorizes us to issue up to 1,000,000,000 shares of common stock and up to 100,000,000 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 our shares of common stock or securities convertible into our common stock from time to time in connection with a financing, acquisition, investment, our stock incentive plans or otherwise. Any such issuance could result in substantial dilution to our existing stockholders and cause the trading price of our common stock to decline.

Insiders have substantial control over us, which could limit your ability to influence the outcome of key transactions, including a change of control.

As of July 31, 2013, our directors, executive officers and each of our stockholders who own greater than 5% of our outstanding common stock and their affiliates, in the aggregate, beneficially own approximately 35% of the outstanding shares of our common stock. As a result, these stockholders, if acting together, will be able to influence or control matters requiring approval by our stockholders, including the election of directors and the approval of mergers, acquisitions or other extraordinary transactions. They may also have interests that differ from yours and may vote in a way with which you disagree and which may be adverse to your interests. This concentration of ownership may have the effect of delaying, preventing or deterring a change of control of our company, could deprive our stockholders of an opportunity to receive a premium for their common stock as part of a sale of our company and might ultimately affect the market price of our common stock.

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 Securities Exchange Act of 1934, as amended, or the Exchange Act, the listing requirements of the New York Stock Exchange and other applicable securities rules and regulations. Compliance with these rules and regulations will increase our legal and financial compliance costs, make some activities more difficult, time-consuming or costly, and increase 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 and maintain effective disclosure controls and procedures and internal control over financial reporting. In order to maintain and, if required, improve our disclosure controls and procedures and internal control over financial reporting to meet 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.

Because we are no longer an "emerging growth company" as defined in the JOBS Act, we are subject to the independent auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act, enhanced disclosure obligations regarding executive compensation in our periodic reports and proxy statements, and the requirements of holding a nonbinding advisory vote on executive compensation and stockholder approval of any golden parachute payments not previously approved. While we were able to determine in our management's report for fiscal 2013 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 have and will continue to consume management resources and incur significant expenses for Section 404 compliance on an ongoing basis. 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.

In addition, changing laws, regulations, and standards relating to corporate governance and public disclosure, such as continued rulemaking pursuant to the Dodd-Frank Act of 2010 and related rules and regulations regarding the disclosure of conflict minerals that are mandated by the Dodd-Frank Act, 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 director and officer liability insurance, and 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 controls over financial reporting. We may not complete our analysis of our internal controls over financial reporting in a timely manner, or these internal controls 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.

We are required, pursuant to the Exchange Act, to furnish a report by management on, among other things, the effectiveness of our internal control over financial reporting. This assessment will need to include disclosure of any material weaknesses identified by our management in our internal control over financial reporting, as well as a statement that our auditors have issued an attestation report on our internal controls.

While we were able to determine in our management's report for fiscal 2013 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 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. During the evaluation and testing process, if we identify one or more material weaknesses in our internal control over financial reporting that we are unable to remediate before the end of the same fiscal year in which the material weakness is identified, we will be unable to assert that our internal controls are effective. If we are unable to assert that our internal control over financial reporting is effective, or if our auditors are unable to attest to the effectiveness of our internal controls or determine we have a material weakness in our internal controls, we could lose investor confidence in the accuracy and completeness of our financial reports, which would cause the price of our common stock to decline.

If securities or industry analysts do not publish research or reports about our business, or publish inaccurate or unfavorable research reports about our business, our share price and trading volume could decline.

The trading market for our common stock, to some extent, depends on the research and reports that securities or industry analysts publish about us or our business. We do not have any control over these analysts. If one or more of the analysts who cover us should downgrade our shares or change their opinion of our shares, our share price would likely decline. If one or more of these analysts should cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which could cause our share price or trading volume to decline.

Our charter documents and Delaware law could discourage takeover attempts and lead to management entrenchment.

Our amended and restated certificate of incorporation and amended and restated bylaws contain provisions that could delay or prevent a change in control of our company. These provisions could also make it difficult for stockholders to elect directors that are not nominated by the current members of our board of directors or take other corporate actions, including effecting changes in our management. These provisions include:

- a classified board of directors with three-year staggered terms, which could delay the ability of stockholders to change the membership of a majority of our board of directors;
- the ability of 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, which could be used to significantly dilute the ownership of a hostile acquiror;
- the exclusive right of our board of directors 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, which prevents stockholders from being able to fill vacancies on our board of directors;

- a prohibition on stockholder action by written consent, which forces stockholder action to be taken at an annual or special meeting of our stockholders;
- the requirement that a special meeting of 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, which could delay the ability of our stockholders to force consideration of a proposal or to take action, including the removal of directors;
- the requirement for 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, which may inhibit the ability of an acquiror to effect such amendments to facilitate an unsolicited takeover attempt;
- the ability of our board of directors, by majority vote, to amend the bylaws, which may allow our board of directors to take additional actions to prevent an unsolicited takeover and inhibit the ability of an acquiror to amend the bylaws to facilitate an unsolicited takeover attempt; and
- advance notice procedures with which stockholders must comply to nominate candidates to our board of directors or to propose matters to be acted upon at a stockholders’ meeting, which may discourage or deter a potential acquiror from conducting a solicitation of proxies to elect the acquiror’s own slate of directors or otherwise attempting to obtain control of us.

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.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our corporate headquarters is located in Santa Clara, California where we currently lease approximately 105,664 square feet of space under a lease agreement that expires in March 2018. On September 20, 2012, we entered into two lease agreements for an aggregate of approximately 300,000 square feet of space in Santa Clara, California to serve as our new corporate headquarters beginning in November 2013. In July 2013, we entered into a sub-lease agreement for the current corporate headquarters with a lease inception date of January 2014. We have an additional technical support center in Plano, Texas under a lease agreement that expires in October 2016. We also lease space for operations and sales personnel in locations throughout the United States and various international locations, including the Netherlands, Singapore, the United Kingdom, Japan, Australia, Canada, and France. We believe that our current facilities are adequate to meet our current needs. We intend to expand our facilities or add new facilities as we add employees and enter new geographic markets, and we believe that suitable additional or alternative space will be available as needed to accommodate ongoing operations and any such growth. However, we expect to incur additional expenses in connection with such new or expanded facilities.

ITEM 3. LEGAL PROCEEDINGS

The information set forth under the "Litigation" subheading in Note 6. Commitments and Contingencies of Notes to Consolidated Financial Statements in Part II, Item 8 of this Annual Report on Form 10-K is incorporated herein by reference.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER REPURCHASES OF EQUITY SECURITIES

Market Information

Our common stock, $0.0001 par value per share, began trading on the New York Stock Exchange on July 20, 2012, where its prices are quoted under the symbol "PANW."

Holders of Record

As of September 10, 2013, there were 190 holders of record of our common stock. Because many of our shares of common stock are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these record holders.

Price Range of Our Common Stock

The following table sets forth the reported high and low sales prices of our common stock for the periods indicated, as regularly quoted on the New York Stock Exchange:

Year Ended July 31, 2012	High	Low
Fourth Quarter (from July 20, 2012)	$ 62.07	$ 51.10
Year Ended July 31, 2013		
First Quarter	$ 72.61	$ 53.27
Second Quarter	$ 57.65	$ 47.00
Third Quarter	$ 62.19	$ 50.29
Fourth Quarter	$ 56.60	$ 39.08

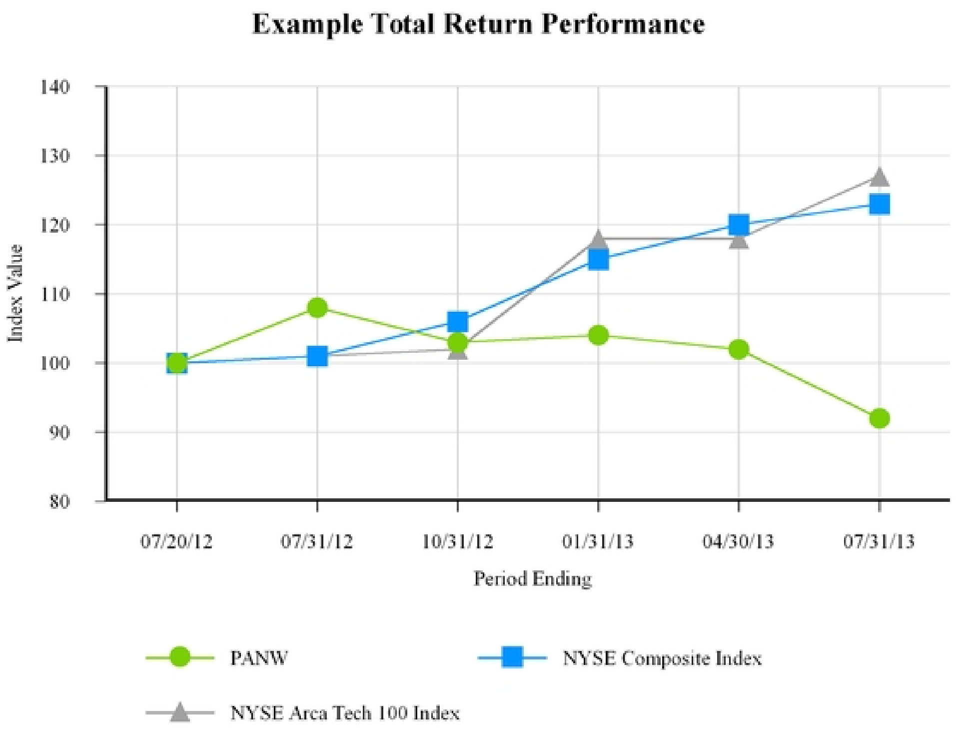
Dividend Policy

We have never declared or paid, and do not anticipate declaring or paying in the foreseeable future, any cash dividends on our capital stock. Any future determination as to the declaration and payment of dividends, if any, will be at the discretion of our board of directors, subject to applicable laws and will depend on then existing conditions, including our financial condition, operating results, contractual restrictions, capital requirements, business prospects, and other factors our board of directors may deem relevant.

Stock Price Performance Graph

This performance graph shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the Exchange Act), or incorporated by reference into any filing of Palo Alto Networks, Inc. under the Securities Act of 1933, as amended, or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.

This performance graph compares the cumulative total return on our common stock with that of the NYSE Composite Index and the NYSE Arca Tech 100 Index. This performance graph assumes $100 was invested on July 20, 2012, in each of the common stock of Palo Alto Networks, Inc., the NYSE Composite Index and the NYSE Arca Tech 100 Index, and assumes the reinvestment of any dividends. The stock price performance on this performance graph is not necessarily indicative of future stock price performance.



Company/Index	7/20/2012	7/31/2012	10/31/2012	1/31/2013	4/30/2013	7/31/2013
Palo Alto Networks, Inc.	$ 100.00	$ 107.55	$ 103.48	$ 104.20	$ 101.83	$ 92.11
NYSE Comp	$ 100.00	$ 101.34	$ 105.95	$ 114.63	$ 119.55	$ 123.19
NYSE Arca Tech 100	$ 100.00	$ 101.35	$ 101.94	$ 113.77	$ 118.29	$ 127.39

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The selected consolidated statement of operations data for fiscal 2013, 2012, and 2011 and the consolidated balance sheet data as of July 31, 2013 and 2012 are derived from our audited consolidated financial statements included elsewhere in this Annual Report on Form 10-K. The selected consolidated statement of operations data for fiscal 2010 and 2009 and the consolidated balance sheet data as of July 31, 2011, 2010, and 2009 are derived from audited financial statements not included in this Annual Report on Form 10-K. Our historical results are not necessarily indicative of the results that may be expected in the future. The selected consolidated financial data below should be read in conjunction with the section entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in Part II, Item 7 of this Annual Report on Form 10-K and our consolidated financial statements and related notes included in Part II, Item 8 of this Annual Report on Form 10-K.

	Year Ended July 31,				
	2013	2012	2011	2010	2009
	(in thousands)				
Selected Consolidated Statements of Operations Data:					
Revenue:					
Product	$ 243,707	$ 174,462	$ 84,800	$ 36,789	$ 10,110
Services	152,400	80,676	33,797	11,993	3,242
Total revenue	396,107	255,138	118,597	48,782	13,352
Cost of revenue:					
Product(1)	63,412	44,615	21,766	10,822	3,952
Services(1)	46,344	25,938	10,507	4,812	2,324
Total cost of revenue	109,756	70,553	32,273	15,634	6,276
Total gross profit	286,351	184,585	86,324	33,148	7,076
Operating expenses:					
Research and development(1)	62,482	38,570	21,366	12,788	8,208
Sales and marketing(1)	199,771	115,917	62,254	29,726	15,372
General and administrative(1)	42,719	26,207	13,108	11,291	2,536
Total operating expenses	304,972	180,694	96,728	53,805	26,116
Operating income (loss)	(18,621)	3,891	(10,404)	(20,657)	(19,040)
Interest income	484	18	3	4	52
Other expense, net	(519)	(1,110)	(1,651)	(424)	(5)
Income (loss) before income taxes	(18,656)	2,799	(12,052)	(21,077)	(18,993)
Provision for income taxes	10,590	2,062	476	56	12
Net income (loss)	$ (29,246)	$ 737	$ (12,528)	$ (21,133)	$ (19,005)
Net income (loss) attributable to common stockholders, basic and diluted	$ (29,246)	$ —	$ (12,528)	$ (21,133)	$ (19,005)
Net income (loss) per share attributable to common stockholders, basic and diluted	$ (0.43)	$ —	$ (0.88)	$ (1.78)	$ (2.01)
Weighted-average shares used to compute net income (loss) per share attributable to common stockholders, basic and diluted	68,682	19,569	14,201	11,901	9,435

(1) Includes share-based compensation expense as follows:

	Year Ended July 31,				
	2013	2012	2011	2010	2009
	(in thousands)				
Cost of product revenue	$ 765	$ 121	$ 27	$ 9	$ 6
Cost of services revenue	3,586	653	179	46	9
Research and development	9,931	3,733	1,020	318	126
Sales and marketing	20,493	4,267	1,133	364	186
General and administrative	9,101	5,151	2,374	132	47
Total share-based compensation	$ 43,876	$ 13,925	$ 4,733	$ 869	$ 374

	July 31,				
	2013	2012	2011	2010	2009
	(In thousands)				
Selected Consolidated Balance Sheet Data:					
Cash and cash equivalents	$ 310,614	$ 322,642	$ 40,517	$ 18,835	$ 21,366
Investments	126,321	—	—	—	—
Working capital	323,597	259,651	9,739	7,000	18,246
Total assets	585,606	407,804	91,172	38,119	28,213
Preferred stock warrant liability	—	—	2,068	491	68
Redeemable convertible preferred stock	—	—	64,491	64,491	64,491
Common stock including additional paid-in capital	381,710	309,099	9,311	2,589	1,200
Total stockholders’ equity (deficit)	272,420	229,071	(71,454)	(65,648)	(45,904)

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis of our financial condition and results of operations together with the consolidated financial statements and related notes that are included elsewhere in this Annual Report on Form 10-K. This discussion contains forward-looking statements based upon current expectations that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth under "Risk Factors" included in Part I, Item 1a or in other parts of this Annual Report on Form 10-K.

Overview

We have pioneered the next generation of network security with our innovative platform that allows enterprises, service providers, and government entities to secure their networks and safely enable the increasingly complex and rapidly growing number of applications running on their networks. The core of our platform is our Next-Generation Firewall, which delivers application, user, and content visibility and control as well as protection against cyber threats integrated within the firewall through our proprietary hardware and software architecture. Our products and services can address a broad range of our end-customers' network security requirements, from the data center to the network perimeter, as well as the distributed enterprise, which includes branch offices and a growing number of mobile devices.

We derive revenue from sales of our products and services, which together comprise our platform. Product revenue is primarily generated from sales of our Next-Generation Firewall which is available in hardware and virtualized platforms. All of our products incorporate our proprietary PAN-OS operating system, which provides a consistent set of capabilities across our entire product line. These capabilities include: application visibility and control (App-ID), user identification (User-ID), site-to-site VPN, remote access SSL VPN, and Quality-of-Service (QoS). Our products are designed for different performance requirements throughout an organization which range from the PA-200, which is designed for enterprise remote offices, to the PA-5060, which is designed for high-speed data centers. The same firewall functionality that is delivered in the hardware platforms is also available in the VM-Series virtual firewalls which secure virtualized and cloud-based computing environments. Multiple firewalls can leverage the WildFire appliance, WF-500, which identifies, analyzes, and blocks known and unknown malware in a private cloud-based environment. Our platform can be centrally managed in both virtualized and hardware platforms across an organization with our Panorama product.

Services revenue includes sales of subscriptions and support and maintenance. Our Threat Prevention, URL Filtering, GlobalProtect, and WildFire subscriptions provide our end-customers with real-time access to the latest antivirus, intrusion prevention, web filtering, and modern malware prevention capabilities across fixed and mobile devices. When end-customers purchase a product, they typically purchase one or more of our subscriptions for additional functionality, as well as support and maintenance in order to receive ongoing security updates, upgrades, bug fixes, and repairs. Sales of these services increase our deferred revenue balance and contribute significantly to our positive cash flow provided by operating activities.

We maintain a field sales force that works closely with our channel partners in developing sales opportunities. We use a two-tier, indirect fulfillment model whereby we sell our products and services to our global distributor channel partners, which, in turn, sell our products and services to our reseller network, which then sell to our end-customers. Our channel partners purchase our products and services at a discount to our list prices before reselling them to our end-customers. Our channel partners generally receive an order from an end-customer prior to placing an order with us and generally do not stock appliances.

For the fiscal year 2013, we added more than 4,800 new customers, including leading government organizations, large healthcare organizations, technology leaders and some of the largest Fortune 100 companies in the world. We had more than 13,500 end-customers in over 120 countries as of July 31, 2013. Our end-customers represent a broad range of industries including education, energy, financial services, healthcare, Internet and media, manufacturing, public sector, and telecommunications. During fiscal 2013, 63% of our revenue was generated from the Americas, 23% from Europe, the Middle East, and Africa (EMEA), and 14% from Asia Pacific and Japan (APAC). As of July 31, 2013, we had 1,147 employees.

We have experienced rapid growth in recent periods. For fiscal 2013, 2012, and 2011, revenues were $396.1 million, $255.1 million, and $118.6 million, respectively, representing year over year growth of 55% for fiscal 2013 and 115% for fiscal 2012, despite continued uncertainty in the macroeconomic environment, in particular, weakness in EMEA and a slowdown in spending by the U.S. Government. These macroeconomic factors may continue to impact overall spending in information technology (IT) by our customers, which could adversely affect our revenues and operating results.

We continue to invest in innovation and strengthening our product portfolio, which resulted in several new product offerings during fiscal 2013. These new product offerings include: the VM-Series, an all-software virtualized next-generation firewall platform that brings next-generation network security into the virtualized data center environment; the paid subscription service for

WildFire, our cloud-based modern malware prevention service platform; the WF-500 appliance which provides the ability to deploy WildFire in a customer's private cloud; the PA-3000 Series firewalls that provide mid-range appliance options for enterprise customers; and lastly, the M-100 management appliance, which offers an easy to deploy, high-performance, dedicated appliance for our Panorama management system.

Fiscal 2013 Financial Highlights

- We added over 4,800 new end-customers during fiscal 2013 and we had more than 13,500 end customers in over 120 countries as of July 31, 2013.
- Total revenue increased 55% to $396.1 million during fiscal 2013 from $255.1 million during fiscal 2012.
- Revenue increased 53% in Americas, 48% in EMEA and 82% in APAC during fiscal 2013 compared to fiscal 2012.
- Service revenue increased 89% to $152.4 million during fiscal 2013 from $80.7 million during fiscal 2012.
- Service revenue as a percentage of total revenue increased to 38% during fiscal 2013 from 32% during fiscal 2012, which reflected the increasing recurring revenue in the business model and the rapid adoption of higher margin subscriptions services in our customer base.
- As of July 31, 2013, we had $436.9 million in cash, cash equivalents, and investments.
- Cash flow provided by operating activities increased 48% to $114.5 million during fiscal 2013 from $77.4 million during fiscal 2012.
- Deferred revenue increased 84% to $249.2 million as of July 31, 2013 from $135.8 million as July 31, 2012 reflected the increased adoption of our support and maintenance and all our subscriptions services.
- We completed the reorganization of our corporate structure and intercompany relationships to more closely align with the international nature of our business activities. Through changes in international procurement and sales operations, our corporate structure may cause short-term volatility but is expected to reduce our overall effective tax rate over the long term.

We believe that the growth of our business and our short 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 within existing end-customers, and focus on end-customer satisfaction. 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.

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. Additionally, we face intense competition in our market, and to succeed, we need to innovate and offer products that are differentiated from existing infrastructure products, as well as effectively hire, retain, train, and motivate qualified personnel and senior management. If we are unable to successfully address these challenges, our business, operating results, and prospects could be adversely affected.

Key Financial Metrics

We monitor the key financial metrics set forth below to help us evaluate growth trends, establish budgets, measure the effectiveness of our sales and marketing efforts, and assess operational efficiencies. We discuss revenue, gross margin, and the components of operating income (loss) and margin below under "—Financial Overview" and "—Results of Operations." Deferred revenue, cash flow provided by operating activities, and free cash flow(non-GAAP) are discussed immediately below the following table.

	July 31,	
	2013	2012
	(in thousands)	
Total deferred revenue	$ 249,230	$ 135,808
Cash, cash equivalents, and investments	$ 436,935	$ 322,642

	Year Ended July 31,		
	2013	2012	2011
	(dollars in thousands)		
Total revenue	$ 396,107	$ 255,138	$ 118,597
Year over year percentage increase	55.3 %	115.1%	143.1 %
Gross margin percentage	72.3 %	72.3%	72.8 %
Operating income (loss)	$ (18,621)	$ 3,891	$ (10,404)
Operating margin percentage	(4.7)%	1.5%	(8.8)%
Cash flow provided by operating activities	$ 114,519	$ 77,368	$ 32,102
Free cash flow (non-GAAP)	$ 92,077	$ 62,803	$ 19,102

- ***Deferred Revenue***. Our deferred revenue consists of amounts that have been invoiced but that have not yet been recognized as revenue as of the period end. The majority of our deferred revenue balance consists of subscription and support and maintenance 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.
- ***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 both subscriptions and support and maintenance. 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 liquidity measure that provides useful information to management and investors about the amount of cash generated by the business that, after the purchases of property, equipment, and other assets, can be used for strategic opportunities, including investing in our business, making strategic acquisitions, and strengthening the balance sheet.

	Year Ended July 31,		
	2013	2012	2011
	(in thousands)		
Cash Flow:			
Cash flow provided by operating activities	$ 114,519	$ 77,368	$ 32,102
Less: purchase of property, equipment, and other assets	22,442	14,565	13,000
Free cash flow (non-GAAP)	$ 92,077	$ 62,803	$ 19,102
Net cash used in investing activities	$ (151,565)	$ (14,565)	$ (13,000)
Net cash provided by financing activities	$ 25,018	$ 219,322	$ 2,580

Financial Overview

Revenue

We derive revenue from sales of our products and services. As discussed further in "—Critical Accounting Policies and Estimates—Revenue Recognition" below, revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectability is reasonably assured.

Our total revenue is comprised of the following:

- ***Product Revenue***. The substantial majority of our product revenue is derived from sales of our appliances. Product revenue also includes revenue derived from software licenses of Panorama, Virtual Systems Upgrades, and the VM-Series. We recognize product revenue at the time of shipment, provided that all other revenue recognition criteria have been met. As a percentage of total revenue, we expect our product revenue to vary from quarter to quarter based on seasonal and cyclical factors.

- ***Services Revenue***. Services revenue is derived primarily from Threat Prevention, URL Filtering, GlobalProtect, and WildFire subscriptions and support and maintenance. Our subscriptions are priced as a percentage of the appliance's list price. Our contractual subscription and support and maintenance terms are typically one to five years. We recognize revenue from subscriptions and support and maintenance over the contractual service period. As a percentage of total revenue, we expect our services revenue to remain at consistent levels or increase over the long term as we introduce new subscriptions, renew existing services contracts, and expand our end-customer base.

Cost of Revenue

Our total cost of revenue consists of cost of product revenue and cost of services revenue. Our cost of revenue includes personnel costs, which consist of salaries, bonuses, and share-based compensation associated with our operations and global customer support organizations. Our cost of revenue also includes allocated costs, which consist of certain facilities, depreciation, benefits, recruiting, and information technology costs that we allocate based on headcount.

- ***Cost of Product Revenue***. Cost of product revenue primarily includes costs paid to our third-party contract manufacturer. Our cost of product revenue also includes product testing costs, allocated costs, warranty costs, shipping costs, and personnel costs associated with logistics and quality control. We expect our cost of product revenue to increase as our product revenue increases.

- ***Cost of Services Revenue***. Cost of services revenue includes personnel costs for our global customer support organization, allocated costs, and URL filtering database service fees. We expect our cost of services revenue to increase as our end-customer base grows.

Gross Margin

Gross margin, or gross profit as a percentage of revenue, has been and will continue to be affected by a variety of factors, including the average sales price of our products, manufacturing costs, the mix of products sold, and the mix of revenue between products and services. For sales of our products, our higher throughput firewall products generally have higher gross margins than our lower throughput firewall products within each product series. For sales of our services, our subscriptions typically have higher gross margins than our support and maintenance. We expect our gross margins to fluctuate over time depending on the factors described above.

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, allocated costs, and with regard to sales and marketing expense, sales commissions. We expect operating expenses to increase in absolute dollars, although they may fluctuate as a percentage of revenue from period to period, as we continue to grow in response to demand for our products and services. As of July 31, 2013, we expect to recognize approximately $133.6 million of share-based compensation expense over a weighted-average period of three years, excluding additional share-based compensation expense related to any future grants of share-based awards. Share-based compensation expense, net of forfeitures, is 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.

- ***Sales and Marketing***. Sales and marketing expense consists primarily of personnel costs including commission costs. We expense commission costs as incurred. Sales and marketing expense also includes costs for market development programs, promotional and other marketing costs, travel costs, office equipment and software, depreciation of capital equipment, professional services, and allocated costs. In the last 12 months, we have significantly increased the size of our sales force and have also 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.

- ***General and Administrative***. General and administrative expense consists of personnel costs as well as professional services. General and administrative personnel include our executive, finance, human resources, and legal organizations. Professional services consist primarily of legal, auditing, accounting, and other consulting costs. We expect general and administrative expense to increase in absolute dollars due to additional legal costs related to ongoing IP litigation, and additional costs associated with accounting, compliance, insurance, investor relations, and other costs associated with being a public company, although our general and administrative expense may fluctuate as a percentage of total revenue. Refer to the discussion under “Legal Proceedings” included in Part I, Item 3 of this Annual Report on Form 10-K for information related to pending litigation.

Interest Income

Interest income consists of income earned on our cash and cash equivalents and investments. We expect interest income will increase as we grow our cash and investments portfolio depending on our average investment balances during the period, types and mix of investments, and market interest rates.

Other Expense, Net

Other expense, net consists primarily of foreign currency remeasurement gains and losses, foreign currency transaction gains and losses, and the change in the fair value of our convertible preferred stock warrant liability. Convertible preferred stock warrants were classified as a liability on our consolidated balance sheets and remeasured to fair value at each balance sheet date with the corresponding change recorded as other expense. These warrants were exercised during the second quarter of fiscal 2012, and therefore, no charges related to these warrants were incurred after that date. We expect other expense to fluctuate depending on foreign exchange rate movements.

Provision for Income Taxes

Provision for income taxes consists primarily of federal and state income taxes in the United States, income taxes in foreign jurisdictions in which we conduct business, and foreign withholding taxes. We maintain a full valuation allowance for domestic deferred tax assets, including net operating loss carryforwards and research and development and other tax credits. We expect the provision for income taxes to increase in absolute dollars in future years.

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 cause volatility to our overall effective tax rate in the short term but is expected to reduce our overall effective tax rate over the long term through changes in international procurement and sales operations.

Results of Operations

The following tables summarize our results of operations for the periods presented and as a percentage of our total revenue for those periods. The period to period comparison of results is not necessarily indicative of results for future periods.

	Year Ended July 31,		
	2013	2012	2011
	(in thousands)		
Consolidated Statements of Operations Data:			
Revenue:			
Product	$ 243,707	$ 174,462	$ 84,800
Services	152,400	80,676	33,797
Total revenue	396,107	255,138	118,597
Cost of revenue:			
Product	63,412	44,615	21,766
Services	46,344	25,938	10,507
Total cost of revenue	109,756	70,553	32,273
Total gross profit	286,351	184,585	86,324
Operating expenses:			
Research and development	62,482	38,570	21,366
Sales and marketing	199,771	115,917	62,254
General and administrative	42,719	26,207	13,108
Total operating expenses	304,972	180,694	96,728
Operating income (loss)	(18,621)	3,891	(10,404)
Interest income	484	18	3
Other expense, net	(519)	(1,110)	(1,651)
Income (loss) before income taxes	(18,656)	2,799	(12,052)
Provision for income taxes	10,590	2,062	476
Net income (loss)	$ (29,246)	$ 737	$ (12,528)

	Year Ended July 31, 2013	2012	2011
	(as a percentage of revenue)		
Consolidated Statements of Operations Data:			
Revenue:			
Product	61.5 %	68.4 %	71.5 %
Services	38.5 %	31.6 %	28.5 %
Total revenue	100.0 %	100.0 %	100.0 %
Cost of revenue:			
Product	16.0 %	17.5 %	18.4 %
Services	11.7 %	10.2 %	8.8 %
Total cost of revenue	27.7 %	27.7 %	27.2 %
Total gross profit	72.3 %	72.3 %	72.8 %
Operating expenses:			
Research and development	15.8 %	15.1 %	18.0 %
Sales and marketing	50.4 %	45.4 %	52.5 %
General and administrative	10.8 %	10.3 %	11.1 %
Total operating expenses	77.0 %	70.8 %	81.6 %
Operating income (loss)	(4.7)%	1.5 %	(8.8)%
Interest income	0.1 %	— %	— %
Other expense, net	(0.1)%	(0.4)%	(1.4)%
Income (loss) before income taxes	(4.7)%	1.1 %	(10.2)%
Provision for income taxes	2.7 %	0.8 %	0.4 %
Net income (loss)	(7.4)%	0.3 %	(10.6)%

Comparison of Fiscal 2013 and 2012

Revenue

	Year Ended July 31, 2013		2012		Change	
	Amount	% of Revenue	Amount	% of Revenue	Amount	%
	(dollars in thousands)					
Revenue:						
Product	$ 243,707	61.5%	$ 174,462	68.4%	$ 69,245	39.7%
Services	152,400	38.5%	80,676	31.6%	71,724	88.9%
Total revenue	$ 396,107	100.0%	$ 255,138	100.0%	$ 140,969	55.3%
Revenue by geographic theater:						
Americas	$ 247,616	62.5%	$ 161,873	63.4%	$ 85,743	53.0%
EMEA	91,496	23.1%	61,994	24.3%	29,502	47.6%
APAC	56,995	14.4%	31,271	12.3%	25,724	82.3%
Total revenue	$ 396,107	100.0%	$ 255,138	100.0%	$ 140,969	55.3%

Product revenue increased $69.2 million, or 39.7%, for fiscal 2013 compared to fiscal 2012. Approximately two-thirds of the increase was driven by our newly introduced PA-3000 Series firewalls and M-100 management appliance. The remaining increase was driven by a greater than 50% increase in product unit volume attributable to sales of our PA-5000 Series and PA-200 firewalls.

Service revenue increased $71.7 million, or 88.9%, for fiscal 2013 compared to fiscal 2012. Approximately half of the increase was related to support and maintenance as a result of an increase in total end-customers to more than 13,500 at July 31, 2013 from more than 9,000 at July 31, 2012. The remaining increase was due to an increase in subscriptions from new and existing end-customers. The relative increases in revenue from subscriptions and support and maintenance will fluctuate over time, depending on the mix of services revenue and the introduction of new services offerings.

With respect to geographic theaters, the Americas contributed the largest portion of the increase in revenue for fiscal 2013 compared to fiscal 2012 due to its larger and more established sales force compared to our other theaters. Revenue from both EMEA and APAC increased during fiscal 2013 compared to fiscal 2012 due to our investment in increasing the size of our sales force and number of partners in these theaters.

Cost of Revenue and Gross Margin

	Year Ended July 31,					
	2013		2012		Change	
	Amount	Gross Margin	Amount	Gross Margin	Amount	Gross Margin
	(dollars in thousands)					
Cost of revenue:						
Product	$ 63,412		$ 44,615		$ 18,797	
Services	46,344		25,938		20,406	
Total cost of revenue	$ 109,756		$ 70,553		$ 39,203	
Gross profit:						
Product	$ 180,295	74.0%	$ 129,847	74.4%	$ 50,448	(0.4)%
Services	106,056	69.6%	54,738	67.8%	51,318	1.8 %
Total gross profit	$ 286,351	72.3%	$ 184,585	72.3%	$ 101,766	— %

Product cost increased $18.8 million, or 42.1%, for fiscal 2013 compared to fiscal 2012 due to an increase in product unit volume, including sales of our newly introduced PA-3000 Series firewalls and M-100 management appliance.

Service cost increased $20.4 million, or 78.7%, for fiscal 2013 compared to fiscal 2012 due to an increase in personnel costs of $9.5 million, including share-based compensation of $2.9 million. The remaining increase was attributable to other costs incurred to expand our customer service capabilities to support our growing end-customer base.

Gross margin for fiscal 2013 remained consistent with fiscal 2012. The decrease of 40 basis points in product margin was due to an 80 basis point decrease as a result of the introduction of our PA-3000 Series firewalls, WF-500 appliance and our M-100 management appliance, which will have lower product margins until volume and related cost savings increase, partially offset by decreases in manufacturing costs for other appliances. The increase of 180 basis points in services margin was due to an increase in subscription, support and maintenance without a proportionate increase in our global customer service organization costs. The mix in services revenue was largely unchanged on a period over period basis.

Operating Expenses

	Year Ended July 31,					
	2013		2012		Change	
	Amount	% of Revenue	Amount	% of Revenue	Amount	%
	(dollars in thousands)					
Operating expenses:						
Research and development	$ 62,482	15.8%	$ 38,570	15.1%	$ 23,912	62.0%
Sales and marketing	199,771	50.4%	115,917	45.4%	83,854	72.3%
General and administrative	42,719	10.8%	26,207	10.3%	16,512	63.0%
Total operating expenses	$ 304,972	77.0%	$ 180,694	70.8%	$ 124,278	68.8%
Includes share-based compensation of:						
Research and development	$ 9,931		$ 3,733		$ 6,198	166.0%
Sales and marketing	20,493		4,267		16,226	380.3%
General and administrative	9,101		5,151		3,950	76.7%
Total	$ 39,525		$ 13,151		$ 26,374	200.5%

Research and development expense increased $23.9 million, or 62.0%, for fiscal 2013 compared to fiscal 2012 due to an increase in personnel costs of $16.1 million related to increasing our headcount and share-based compensation, an increase in allocated costs of $3.7 million, and an increase in development costs of $2.8 million to support continued investment in our future product and service offerings.

Sales and marketing expense increased $83.9 million, or 72.3%, for fiscal 2013 compared to fiscal 2012 due to an increase in personnel costs of $58.0 million largely due to an increase in headcount, share-based compensation, and commission costs, an increase in allocated costs of $10.7 million, and an increase in marketing activity of $5.6 million related to demand generation activities, trade shows, and other marketing activities. The remaining increase was due to an increase in travel and entertainment costs of $5.6 million, professional service costs of $2.0 million, and office equipment and software costs of $1.9 million in support of our sales efforts.

General and administrative expense increased $16.5 million, or 63.0%, for fiscal 2013 compared to fiscal 2012 due to an increase in professional services costs of $6.9 million, including expenses related to ongoing IP litigation with Juniper of $3.6 million. We expect that these litigation expenses will increase in fiscal 2014 as we approach the February 2014 trial date. The remaining increase was due to an increase in personnel costs of $6.6 million, and an increase in allocated costs of $2.3 million related to overall growth to support the business and building our infrastructure to meet the regulatory requirements of being a public company.

Other Expense, Net

	Year Ended July 31,			
	2013	2012	Change	
	Amount	Amount	Amount	%
	(dollars in thousands)			
Other expense, net	$ 519	$ 1,110	$ (591)	(53.2)%

Other expense, net consisted primarily of foreign currency remeasurement losses for fiscal 2013 and the change in fair value of our preferred stock warrant liability for fiscal 2012. The decrease in other expense, net was due to the elimination of the expense related to preferred stock warrant liability as a result of exercise of these warrants by the holders in December 2011 and January 2012, partially offset by an increase in foreign currency remeasurement loss.

Provision for Income Taxes

	Year Ended July 31,			
	2013	2012	Change	
	Amount	Amount	Amount	%
	(dollars in thousands)			
Provision for income taxes	$ 10,590	$ 2,062	$ 8,528	413.6%
Effective tax rate	(56.8)%	73.7%		

We recorded an income tax provision for fiscal 2013 due to U.S. federal income taxes, state income taxes, foreign income taxes, and foreign withholding taxes. We have a valuation allowance for our domestic deferred tax assets. The provision for income taxes increased for fiscal 2013 compared to fiscal 2012 due to a significant increase in domestic taxable income after full utilization of federal net operating loss carryforwards. In addition, our global operations and foreign presence expanded year over year giving rise to additional foreign income taxes and foreign withholding taxes.

During the fourth quarter of fiscal 2013, we completed the reorganization of our corporate structure and intercompany relationships to more closely align with the international nature of our business activities. Our corporate structure may cause volatility to our overall effective tax rate in the short term but is expected to reduce our overall effective tax rate over the long term through changes in international procurement and sales operations.

Comparison of Fiscal 2012 and 2011

Revenue

	Year Ended July 31,					
	2012		2011		Change	
	Amount	% of Revenue	Amount	% of Revenue	Amount	%
	(dollars in thousands)					
Revenue:						
Product	$ 174,462	68.4%	$ 84,800	71.5%	$ 89,662	105.7%
Services	80,676	31.6%	33,797	28.5%	46,879	138.7%
Total revenue	$ 255,138	100.0%	$ 118,597	100.0%	$ 136,541	115.1%
Revenue by geographic theater:						
Americas	$ 161,873	63.4%	$ 73,145	61.7%	$ 88,728	121.3%
EMEA	61,994	24.3%	32,504	27.4%	29,490	90.7%
APAC	31,271	12.3%	12,948	10.9%	18,323	141.5%
Total revenue	$ 255,138	100.0%	$ 118,597	100.0%	$ 136,541	115.1%

Product revenue increased $89.7 million, or 105.7%, for fiscal 2012 compared to fiscal 2011. The increase was primarily driven by an aggregate increase of more than 75% in product unit volume and the introduction of our higher-end PA-5000 Series as opposed to increases in the average selling prices of our other products, which remained relatively flat.

Service revenue increased $46.9 million, or 138.7%, for fiscal 2012 compared to fiscal 2011. The increase was primarily driven by new end-customers and, to a lesser extent, additional sales of subscription services to our existing end-customer base. Our total number of end-customers increased to over 9,000 at July 31, 2012 from approximately 4,700 at July 31, 2011.

With respect to geographic theaters, the Americas contributed the largest portion of the increase in revenue for fiscal 2012 compared to fiscal 2011 due to its larger and more established sales force compared to our other theaters. Revenue from both EMEA and APAC increased during fiscal 2012 compared to fiscal 2011 due to our investment in increasing the size of our sales force and number of partners in these theaters.

Cost of Revenue and Gross Margin

	Year Ended July 31,					
	2012		2011		Change	
	Amount	Gross Margin	Amount	Gross Margin	Amount	Gross Margin
	(dollars in thousands)					
Cost of revenue:						
Product	$ 44,615		$ 21,766		$ 22,849	
Services	25,938		10,507		15,431	
Total cost of revenue	$ 70,553		$ 32,273		$ 38,280	
Gross profit:						
Product	$ 129,847	74.4%	$ 63,034	74.3%	$ 66,813	0.1 %
Services	54,738	67.8%	23,290	68.9%	31,448	(1.1)%
Total gross profit	$ 184,585	72.3%	$ 86,324	72.8%	$ 98,261	(0.5)%

Gross margin decreased 50 basis points for fiscal 2012 compared to fiscal 2011. The increase of 10 basis points in product margin was primarily due to an increase in sales volume as opposed to changes in average selling prices of our hardware on a per unit basis. This increase in margin was partially offset by the impact of introducing our PA-200, which is a lower throughput firewall product. On average, margins for firewall products with lower throughput are less than firewall products with higher throughput. The decrease of 110 basis points in services margin was primarily due to a decrease in average margins on revenue from support and maintenance as a result of an increase in personnel and other costs to support our expanding end-customer base, partially offset by higher margin subscriptions sales, while the mix in services revenue was largely unchanged on a period over period basis.

Operating Expenses

	Year Ended July 31,					
	2012		2011		Change	
	Amount	% of Revenue	Amount	% of Revenue	Amount	%
	(dollars in thousands)					
Operating expenses:						
Research and development	$ 38,570	15.1%	$ 21,366	18.0%	$ 17,204	80.5%
Sales and marketing	115,917	45.4%	62,254	52.5%	53,663	86.2%
General and administrative	26,207	10.3%	13,108	11.1%	13,099	99.9%
Total operating expenses	$ 180,694	70.8%	$ 96,728	81.6%	$ 83,966	86.8%
Includes share-based compensation of:						
Research and development	$ 3,733		$ 1,020		$ 2,713	266.0%
Sales and marketing	4,267		1,133		3,134	276.6%
General and administrative	5,151		2,374		2,777	117.0%
Total	$ 13,151		$ 4,527		$ 8,624	190.5%

Research and development expense increased $17.2 million, or 80.5%, for fiscal 2012 compared to fiscal 2011, primarily due to an increase in personnel costs of $11.6 million as we increased our headcount to support continued investment in our future product and service offerings and an increase in allocated costs and development costs of $4.4 million.

Sales and marketing expense increased $53.7 million, or 86.2%, for fiscal 2012 compared to fiscal 2011, primarily due to an increase in personnel costs of $30.6 million due to an increase in headcount and commissions. Additionally, marketing activity increased $7.1 million related to trade shows and conventions and marketing development programs, travel costs increased $5.0 million, and allocated costs increased $4.6 million. The remaining increase was due to increases in depreciation, facilities costs, and professional services costs.

General and administrative expense increased $13.1 million, or 99.9%, for fiscal 2012 compared to fiscal 2011, primarily due to an increase in personnel costs of $6.0 million and an increase in professional services costs of $5.2 million primarily related to overall growth to support the business and infrastructure building in preparation for being a public company. The remaining increase was due to an increase in allocated costs.

Other Expense, Net

	Year Ended July 31,			
	2012	2011	Change	
	Amount	Amount	Amount	%
	(dollars in thousands)			
Other expense, net	$ 1,110	$ 1,651	$ (541)	(32.8)%

The change in other expense, net was due to the increase in fair value of the preferred stock warrant liability during fiscal 2012 compared to fiscal 2011. In December 2011 and January 2012, these preferred stock warrants were exercised by the holders. As a result, we issued 197,000 shares of Series A redeemable convertible preferred stock and 24,000 shares of Series B redeemable convertible preferred stock, all of which converted to common stock at the time of our initial public offering (IPO). The amount for fiscal 2012 represents the change in fair value of the preferred stock warrant liability from the beginning of the period to the dates of exercise of the warrants. We do not expect to incur expenses related to these warrants in future periods.

Provision for Income Taxes

	Year Ended July 31,			
	2012	2011	Change	
	Amount	Amount	Amount	%
	(dollars in thousands)			
Provision for income taxes	$ 2,062	$ 476	$ 1,586	333.2%
Effective tax rate	73.7%	(3.9)%		

We incurred tax expense for fiscal 2012, primarily due to foreign taxes, state income taxes, and U.S. federal alternative minimum tax. We have a full valuation allowance for our domestic deferred tax assets. The increase in the provision for fiscal 2012 compared to fiscal 2011 was primarily due to an increase in state income taxes, U.S. federal alternative minimum tax, and foreign taxes as a result of an increase in our taxable income.

Liquidity and Capital Resources

	July 31,	
	2013	2012
	(in thousands)	
Working capital	$ 323,597	$ 259,651
Cash and cash equivalents	$ 310,614	$ 322,642
Investments	126,321	—
Total cash, cash equivalents, and investments	$ 436,935	$ 322,642

	Year Ended July 31,		
	2013	2012	2011
	(in thousands)		
Cash provided by operating activities	$ 114,519	$ 77,368	$ 32,102
Cash used in investing activities	(151,565)	(14,565)	(13,000)
Cash provided by financing activities	25,018	219,322	2,580
Net increase (decrease) in cash and cash equivalents	$ (12,028)	$ 282,125	$ 21,682

At July 31, 2013, our cash and cash equivalents and investments of $436.9 million were held for working capital purposes, of which approximately $27.2 million was held outside the United States and not presently available to fund domestic operations and obligations. If we were to repatriate cash held outside the United States, it could be subject to U.S. income taxes, less any previously paid foreign income taxes.

We believe that our cash flow from operations with existing cash and cash equivalents will be sufficient to meet our anticipated cash needs for at least the next 12 months. 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 services offerings, the costs to ensure access to adequate manufacturing capacity, and the continuing market acceptance of our products. 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 would be adversely affected.

Operating Activities

Our primary source of cash from operating activities has been from cash collections from our customers. We expect cash inflows from operating activities to be affected by increases in sales and timing of collections. Our primary uses of cash from operating activities have been for personnel costs and purchases from our contract manufacturer. We expect cash outflows from operating activities to be affected by increases in sales and increases in personnel costs as we grow our business. Cash provided by operating activities for fiscal 2013, fiscal 2012, and fiscal 2011 was $114.5 million, $77.4 million, and $32.1 million, respectively.

For fiscal 2013, operating activities provided $114.5 million in cash as a result of our net loss of $29.2 million, non-cash charges of $49.0 million and a net change of $94.7 million in our net operating assets and liabilities. Non-cash charges included share-based compensation, depreciation and amortization, amortization of investment premiums, net of accretion of purchase discounts, and excess tax benefit from share-based compensation. The net change in our net operating assets and liabilities was due to a $113.4 million increase in deferred revenue as a result of increases in sales of subscriptions and support and maintenance, a $26.2 million increase in accrued compensation and other liabilities as a result of increases in personnel expense and business activity, and a $5.8 million increase in accounts payable due to payment timing, partially offset by a $41.8 million increase in accounts receivable due to an increase in sales, in particular, increases in sales volume near the end of the period and sales of multi-year subscription and support and maintenance services, and a $8.9 million increase in prepaid expenses and other assets. Current deferred revenue increased 78.4% from $86.3 million as of July 31, 2012 to $153.9 million as of July 31, 2013. The increase was due to an increase in business volume during the period. Non-current deferred revenue increased 92.4% from $49.5 million as of July 31, 2012 to $95.3 million as of July 31, 2013. The increase was due to a higher proportion of sales of multi-year subscriptions and support and maintenance. Our day's sales outstanding, or DSO, defined as the number of days it takes to turn our average quarterly accounts receivable into cash based on a 90 day average, was 72 days for the quarter ended July 31, 2013, which reflected an increase in accounts receivable for the reasons described above.

For fiscal 2012, operating activities provided $77.4 million in cash as a result of net income of $0.7 million, non-cash charges of $20.7 million, and a net change of $55.9 million in our net operating assets and liabilities. The net change in our net operating assets and liabilities was primarily due to a $68.6 million increase in deferred revenue as a result of increases in sales of subscriptions and support and maintenance, partially offset by a $16.0 million increase in accounts receivable and an $11.1 million increase in prepaid expenses and other assets. Our day's sales outstanding, or DSO, defined as the number of days it takes to turn our average quarterly accounts receivable into cash based on a 90 day average, was 50 days for the quarter ended July 31, 2012.

For fiscal 2011, operating activities provided $32.1 million in cash, primarily as a result of a net loss of $12.5 million, offset by non-cash charges of $8.5 million as well as a net change of $36.1 million in our net operating assets and liabilities. Non-cash charges included share-based compensation, depreciation and amortization, and the change in fair value of our preferred stock warrant liability. The net change in our operating assets and liabilities was primarily the result of a $43.1 million increase in deferred revenue as a result of increases in sales of subscriptions and support and maintenance and a $9.1 million increase in accrued compensation and other liabilities primarily due to deferred rent related to moving our headquarters from Sunnyvale, California to Santa Clara, California. These increases were partially offset by a $15.4 million increase in accounts receivable due to an increase in sales and a $5.1 million increase in prepaid expenses and other assets as a result of growth in our business. Our DSO was 57 days for the quarter ended July 31, 2011.

Investing Activities

Our investing activities have consisted of purchases of property, equipment, and other assets and purchases, sales, and maturities of investments. We expect to continue such activities as our business grows.

For fiscal 2013, cash used in investing activities was $151.6 million, as a result of $345.3 million in purchases of short-term and long-term investments to shift the mix of investments from money market funds to higher yield corporate notes and bonds and U.S. government agency securities, and capital expenditures to purchase property, equipment, and other assets of $22.4 million, partially offset by proceeds from sales and maturities of investments of $216.2 million.

Cash used in investing activities for fiscal 2012 and 2011, was $14.6 million and $13.0 million, respectively, and was primarily the result of capital expenditures to purchase property and equipment, including $7.0 million for fiscal 2012 related to purchases of demonstration units for use by our customers in evaluating our products and services and capitalized internally developed software costs related to the implementation of our enterprise resource planning system and $7.3 million for fiscal 2011 related to moving our headquarters from Sunnyvale, California to Santa Clara, California.

Financing Activities

Our financing activities have consisted of proceeds from the sale of our common stock in our IPO proceeds from the exercises of stock options and the employee stock purchase plan.

For fiscal 2013, financing activities provided $25.0 million in cash, as a result of proceeds from the exercises of stock options and the employee stock purchase plan of $21.0 million and excess tax benefit from share-based compensation of $6.8 million, partially offset by payments of costs related to our IPO of $2.7 million.

For fiscal 2012, financing activities provided $219.3 million in cash as a result of net proceeds to us from our IPO and the exercises of stock options. On July 25, 2012, we completed our IPO, in which 7,130,000 shares of common stock were sold to the public (inclusive of 5,617,000 shares of common stock sold by us). The public offering price of the shares sold in the IPO was $42.00 per share. After deducting underwriting discounts and commissions, offering expenses payable by us, and net proceeds received by the selling stockholders, the aggregate net proceeds received by us totaled approximately $215.4 million.

For fiscal 2011, financing activities provided $2.6 million in cash as a result of proceeds from the exercises of stock options.

Contractual Obligations and Commitments

The following summarizes our contractual obligations and commitments as of July 31, 2013:

	Payments Due by Period				
	Total	Less Than 1 Year	1 - 3 Years	3- 5 Years	More Than 5 Years
	(in thousands)				
Operating lease obligations[1] [2]	$ 108,313	$ 7,728	$ 24,634	$ 23,651	$ 52,300
Purchase obligations[3]	19,130	19,130	—	—	—
Total[4]	$ 127,443	$ 26,858	$ 24,634	$ 23,651	$ 52,300

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(1) Consists of contractual obligations from non-cancelable office space under operating leases.

(2) Excludes proceeds from contractual sublease of $10.7 million, which consists of $0.1 million to be received in less than one year, $5.5 million to be received in one to three years, $5.1 million to be received in three to five years and nil to be received in more than five years.

(3) Consists of minimum purchase commitments of products and components with our independent contract manufacturer and original design manufacturers. Obligations under contracts that we can cancel without a significant penalty are not included in the table above.

(4) No amounts related to Financial Accounting Standards Board Accounting Standard Codification Topic 740-10, Income Taxes, are included. As of July 31, 2013, we had approximately $2.4 million of tax liabilities recorded related to uncertainty in income tax positions.

Off-Balance Sheet Arrangements

Through July 31, 2013, 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 Policies and Estimates

Our consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, expenses, and related disclosures. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. We evaluate our estimates and assumptions on an ongoing basis. Actual results may differ from these estimates. To the extent that there are material differences between these estimates and our actual results, our future financial statements will be affected.

The critical accounting policies requiring estimates, assumptions, and judgments that we believe have the most significant impact on our consolidated financial statements are described below.

Revenue Recognition

We generate revenue from the sales of hardware and software products, subscriptions, support and maintenance, and other services primarily through a direct sales force and indirect relationships with channel partners, and, to a lesser extent, directly to end-customers.

Revenue is recognized when all of the following criteria are met:

- ***Persuasive Evidence of an Arrangement Exists.*** We rely upon non-cancelable sales agreements and purchase orders to determine the existence of an arrangement.
- ***Delivery has Occurred.*** We use shipping documents or transmissions of product or service contract registration codes to determine delivery.
- ***The Fee is Fixed or Determinable.*** We assess whether the fee is fixed or determinable based on the payment terms associated with the transaction.
- ***Collectability is Reasonably Assured.*** We assess collectability based on credit analysis and payment history.

We recognize product revenue at the time of shipment provided that all other revenue recognition criteria have been met. Our partners generally receive an order from an end-customer prior to placing an order with us. In addition, payment from our partners is not contingent on the partner's success in sales to end-customers. Our partners generally do not stock appliances and only have limited stock rotation rights and no price protection rights. When necessary, we make certain estimates and maintain allowances for sales returns and other programs based on our historical experience. These estimates involve inherent uncertainties and management's judgment. If actual results deviate significantly from our estimates, our revenue could be adversely affected. We recognize services revenue from subscriptions and support and maintenance ratably over the contractual service period, which is typically one to five years. Other services revenue is recognized as the services are rendered and has not been significant to date.

Most of our arrangements, other than renewals of subscriptions and support and maintenance, are multiple-element arrangements with a combination of hardware, software, subscriptions, support and maintenance, and other services. Products and services generally qualify as separate units of accounting. Our hardware deliverables typically include proprietary operating system software, which together deliver the essential functionality of our products. For multiple-element arrangements, we allocate revenue to each unit of accounting based on an estimated selling price at the arrangement inception. The estimated selling price for each element is based upon the following hierarchy: vendor-specific objective evidence (VSOE) of selling price, if available, third-party evidence (TPE) of selling price, if VSOE of selling price is not available, or best estimate of selling price (BESP), if neither VSOE of selling price nor TPE of selling price are available. The total arrangement consideration is allocated to each separate unit of accounting using the relative estimated selling prices of each unit based on the aforementioned selling price hierarchy. We limit the amount of revenue recognized for delivered elements to an amount that is not contingent upon future delivery of additional products or services or meeting any specified performance conditions.

To determine the estimated selling price in multiple-element arrangements, we establish VSOE of selling price using the prices charged for a deliverable when sold separately. If VSOE of selling price cannot be established for a deliverable, we establish TPE of selling price by evaluating similar and interchangeable competitor products or services in standalone arrangements with similarly situated partners. However, as our products contain a significant element of proprietary technology and offer substantially different features and functionality from our competitors, we are unable to obtain comparable pricing of our competitors' products with similar functionality on a standalone basis. Therefore, we have not been able to obtain reliable evidence of TPE of selling price. If neither VSOE nor TPE of selling price can be established for a deliverable, we establish BESP primarily based on historical transaction pricing. Historical transactions are segregated based on our pricing model and our go-to-market strategy, which include factors such as type of sales channel (reseller, distributor, or end-customer), the geographies in which our products and services were sold (domestic or international), offering type (products or services), and whether or not the opportunity was identified by our sales force or by our partners. In analyzing historical transaction pricing, we evaluate whether a majority of the prices charged for a product or service, as represented by a percentage of list price, fall within a reasonable range. To further support the best estimate of selling price as determined by the historical transaction pricing or when such information is unavailable, such as when there are limited sales of a new product or service, we consider the same factors we have established through our pricing model and go-to-market strategy. The determination of BESP is made through consultation with and approval by our management. In determining BESP, we rely on certain assumptions and apply significant judgment. As our business offerings evolve over time, we may be required to modify our estimated selling prices in subsequent periods, and our revenue could be adversely affected.

In multiple-element arrangements where software deliverables are included, revenue is allocated to each separate unit of accounting for each of the non-software deliverables and to the software deliverables as a group using the relative estimated selling prices of each of the deliverables in the arrangement based on the aforementioned estimated selling price hierarchy. The arrangement consideration allocated to the software deliverables as a group is then allocated to each software deliverable using the residual method when VSOE of fair value of the undelivered items exists. Under the residual method, the amount of revenue allocated to delivered elements equals the total arrangement consideration less the aggregate fair value of any undelivered elements. In determining VSOE of fair value, we evaluate whether a substantial majority of the historical prices charged for a product or service sold on a standalone basis, as represented by a percentage of list price, fall within a reasonably narrow range. If VSOE of fair value of one or more undelivered items does not exist, revenue from the entire arrangement is deferred and recognized at the earlier of: (i) delivery of those elements or (ii) when fair value can be established unless support and maintenance is the only undelivered element, in which case, the entire arrangement fee is recognized ratably over the contractual service period.

Share-Based Compensation

Compensation expense related to share-based transactions, including employee and non-employee director awards, is measured and recognized in the financial statements based on fair value. The fair value of option awards and purchases under our 2012 Employee Stock Purchase Plan (2012 ESPP) is estimated on the grant date. The fair value of restricted stock units (RSUs) is based on the closing market price of our common stock on the date of grant. The share-based compensation expense, net of forfeitures, is recognized using a straight-line basis over the requisite service periods of the awards. We estimate a forfeiture rate to calculate the share-based compensation expense for our awards. Our forfeiture rate is based on an analysis of our actual historical forfeitures.

The fair value of options and shares sold through our 2012 ESPP is determined using the Black-Scholes option-pricing model. Our option-pricing model requires the input of the fair value of our common stock and other subjective assumptions, including the expected term of the award, the expected volatility of the price of our common stock, risk-free interest rates, and the expected dividend yield of our common stock. The assumptions used in our option-pricing model represent management’s best estimates. These estimates involve inherent uncertainties and the application of management’s judgment. If factors change and different assumptions are used, our share-based compensation expense could be materially different in the future.

In addition to assumptions used in the Black-Scholes option-pricing model, we must also estimate a forfeiture rate to calculate the share-based compensation expense for our awards. Quarterly changes in the estimated forfeiture rate can have a significant impact on our share-based compensation expense as the cumulative effect of adjusting the rate is recognized in the period the forfeiture estimate is changed. If a revised forfeiture rate is higher than the previously estimated forfeiture rate, an adjustment is made that will result in a decrease to the share-based compensation expense recognized in the financial statements. If a revised forfeiture rate is lower than the previously estimated forfeiture rate, an adjustment is made that will result in an increase to the share-based compensation expense recognized in the financial statements.

We will continue to use judgment in evaluating the assumptions related to our share-based compensation expense on a prospective basis. As we continue to accumulate additional data, we may have refinements to our estimates, which could materially impact our future share-based compensation expense.

Income Taxes

We account for income taxes using the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in our financial statements or tax returns. In addition, deferred tax assets are recorded for the future benefit of utilizing net operating losses and research and development credit carryforwards. Valuation allowances are provided when necessary to reduce deferred tax assets to the amount expected to be realized.

Significant judgment is required in determining any valuation allowance recorded against deferred tax assets. In assessing the need for a valuation allowance, we consider all available evidence, including past operating results, estimates of future taxable income, and the feasibility of tax planning strategies. In the event that we change our determination as to the amount of deferred tax assets that can be realized, we will adjust our valuation allowance with a corresponding impact to the provision for income taxes in the period in which such determination is made.

We apply the authoritative accounting guidance prescribing a threshold and measurement attribute for the financial recognition and measurement of a tax position taken or expected to be taken in a tax return. We recognize liabilities for uncertain tax positions based on a two-step process. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step requires us to estimate and measure the tax liability as the largest amount that is more likely than not to be realized upon ultimate settlement.

Significant judgment is also required in evaluating our uncertain tax positions and determining our provision for income taxes. Although we believe our reserves are reasonable, no assurance can be given that the final tax outcome of these matters will not be different from that which is reflected in our historical income tax provisions and accruals. We adjust these reserves in light of changing facts and circumstances, such as the closing of a tax audit or the refinement of an estimate. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences may impact the provision for income taxes in the period in which such determination is made.

Estimates of future taxable income are based on assumptions that are consistent with our plans. Assumptions represent management’s best estimates and involve inherent uncertainties and the application of management’s judgment. Should actual amounts differ from our estimates, the amount of our tax expense and liabilities could be materially impacted.

Contract Manufacturer Liabilities

We outsource most of our manufacturing, repair, and supply chain management operations to our independent contract manufacturer and payments to it are a significant portion of our product cost of revenues. We have employees in our manufacturing and operations organization who manage our relationship with our independent contract manufacturer, manage our supply chain, and monitor product testing and quality. Although we could be contractually obligated to purchase manufactured products, we generally do not own the manufactured products. Product title transfers from our independent contract manufacturer to us and immediately to our partners upon shipment. Our independent contract manufacturer assembles our products using design specifications, quality assurance programs, and standards that we establish, and it procures components and assembles our products based on our demand forecasts. These forecasts represent our estimates of future demand for our products based upon historical trends and analysis from our sales and product management functions as adjusted for overall market conditions. If the actual component usage and product demand are significantly lower than forecast, which may be caused by factors outside of our control, we accrue for costs for manufacturing commitments in excess of our forecasted demand including costs for excess components or for carrying costs incurred by our contract manufacturer, which could have an adverse impact on our gross margins and profitability. To date, we have not accrued significant costs associated with this exposure.

Loss Contingencies

We are subject to the possibility of various loss contingencies arising in the ordinary course of business. We consider the likelihood of loss or impairment of an asset, or the incurrence of a liability, as well as our ability to reasonably estimate the amount of loss, in determining loss contingencies. An estimated loss contingency is accrued when it is probable that an asset has been impaired or a liability has been incurred and the amount of loss can be reasonably estimated. If we determine that a loss is possible and the range of the loss can be reasonably determined, then we disclose the range of the possible loss. We regularly evaluate current information available to us to determine whether an accrual is required, an accrual should be adjusted or a range of possible loss should be disclosed.

From time to time, we are involved in disputes, litigation, and other legal actions. We are vigorously defending our current litigation matters. However, there are many uncertainties associated with any litigation, and these actions or other third-party claims against us may cause us to incur substantial settlement charges, which are inherently difficult to estimate and could adversely affect our results of operations. The actual liability in any such matters may be materially different from our estimates, which could result in the need to adjust our liability and record additional expenses. Refer to the discussion under “Commitments and Contingencies—Litigation” in Note 6 to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report on Form 10-K for information related to pending litigation.

Impairment of Long-Lived Assets

We evaluate events and changes in circumstances that could indicate carrying amounts of long-lived assets, including property and equipment, may not be recoverable. When such events or changes in circumstances occur, we assess the recoverability of long-lived assets by determining whether or not the carrying value of such assets will be recovered through undiscounted expected future cash flows. If the total of the future undiscounted cash flows is less than the carrying amount of an asset, we record an impairment charge for the amount by which the carrying amount of the assets exceeds the fair value of the asset. Through July 31, 2013, our impairment write-down of long-lived assets was not material.

Warranties

We generally provide a one-year warranty on hardware and a three-month warranty on software. We are indemnified by our contract manufacturer for product liability claims arising out of manufacturing defects. We accrue for potential warranty claims as a component of cost of product revenues based on historical experience and other data. Accrued warranty is recorded in accrued liabilities on the consolidated balance sheets and is reviewed periodically for adequacy. If we experience an increase in warranty claims compared with our historical experience, or if the cost of servicing warranty claims is greater than expected, our gross margin could be adversely affected. To date, we have not accrued any significant costs associated with our warranty.

Recent Accounting Pronouncements

Refer to “Recent Accounting Pronouncements” in Note 1 to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report on Form 10-K.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency Exchange Risk

Our sales contracts are primarily denominated in U.S. dollars. A portion of our operating expenses are incurred outside the United States and are denominated in foreign currencies and are subject to fluctuations due to changes in foreign currency exchange rates, particularly changes in the Euro, British Pound, and Japanese Yen. Additionally, fluctuations in foreign currency exchange rates may cause us to recognize transaction gains and losses in our statement of operations. The effect of an immediate 10% adverse change in foreign exchange rates on monetary assets and liabilities at July 31, 2013 would not be material to our financial condition or results of operations. To date, foreign currency transaction gains and losses and exchange rate fluctuations have not been material to our financial statements, and we have not engaged in any foreign currency hedging transactions.

As our international operations grow, our risks associated with fluctuation in currency rates will become greater, and we will continue to reassess our approach to managing this risk. In addition, currency fluctuations or a weakening U.S. dollar can increase the costs of our international expansion.

Interest Rate Risk

The primary objectives of our investment activities are to preserve principal, provide liquidity, and maximize income without significantly increasing risk. Some of the securities we invest in are subject to interest risk. To minimize this risk, we maintain our portfolio of cash, cash equivalents, and short-term investments in a variety of securities, including commercial paper, money market funds, U.S. government and agency securities, and corporate debt securities. Due to the short duration and conservative nature of our investment portfolio, a movement of 10% in market interest rates would not have a material impact on our operating results and the total value of the portfolio. The effect of an immediate 10% change in interest rates at July 31, 2013 would not have been material to our financial statements assuming consistent investment levels.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Palo Alto Networks, Inc.

We have audited the accompanying consolidated balance sheets of Palo Alto Networks, Inc. as of July 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive income (loss), redeemable convertible preferred stock and stockholders' equity (deficit), and cash flows for each of the three years in the period ended July 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Palo Alto Networks, Inc. at July 31, 2013 and 2012, and the consolidated results of its operations and its cash flows for each of the three years in the period ended July 31, 2013, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Palo Alto Networks, Inc.'s internal control over financial reporting as of July 31, 2013, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) and our report dated September 24, 2013 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

San Francisco, California
September 24, 2013

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Palo Alto Networks, Inc.

We have audited Palo Alto Networks, Inc.'s internal control over financial reporting as of July 31, 2013, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 framework) (the COSO criteria). Palo Alto Networks, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Palo Alto Networks, Inc. maintained, in all material respects, effective internal control over financial reporting as of July 31, 2013, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Palo Alto Networks, Inc. as of July 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive income (loss), redeemable convertible preferred stock and stockholders' equity (deficit), and cash flows for each of the three years in the period ended July 31, 2013 of Palo Alto Networks, Inc. and our report dated September 24, 2013 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

San Francisco, California
September 24, 2013

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management's Report on Internal Control Over Financial Reporting

The management of Palo Alto Networks, Inc. (the “Company”) is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934 for the Company. The Company's internal control over financial reporting is a process designed under the supervision of the Company's principal executive and principal financial officers to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

The Company's internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the Consolidated Financial Statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of the Company's internal control over financial reporting as of July 31, 2013, based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) in Internal Control - Integrated Framework. Based on that assessment, management concluded that, as of July 31, 2013, the Company's internal control over financial reporting was effective.

The effectiveness of the Company's internal control over financial reporting as of July 31, 2013, has been audited by Ernst & Young LLP, the independent registered public accounting firm that audits the Company's Consolidated Financial Statements, as stated in their report preceding this report, which expresses an unqualified opinion on the effectiveness of the Company's internal control over financial reporting as of July 31, 2013.

PALO ALTO NETWORKS, INC.

CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)

	July 31, 2013	July 31, 2012
Assets		
Current assets:		
Cash and cash equivalents	$ 310,614	$ 322,642
Short-term investments	109,007	—
Accounts receivable, net of allowance for doubtful accounts of $51 and $164 at July 31, 2013 and July 31, 2012, respectively	87,461	45,642
Prepaid expenses and other current assets	22,617	13,373
Total current assets	529,699	381,657
Property and equipment, net	32,086	20,979
Long-term investments	17,314	—
Other assets	6,507	5,168
Total assets	$ 585,606	$ 407,804
Liabilities and stockholders’ equity		
Current liabilities:		
Accounts payable	$ 15,544	$ 9,214
Accrued and other liabilities	14,609	15,189
Accrued compensation	22,004	11,307
Deferred revenue	153,945	86,296
Total current liabilities	206,102	122,006
Deferred revenue—non-current	95,285	49,512
Other long-term liabilities	11,799	7,215
Commitments and contingencies (Note 6)		
Stockholders’ equity:		
Preferred stock; $0.0001 par value; 100,000 shares authorized; none issued and outstanding at July 31, 2013 and July 31, 2012	—	—
Common stock, $0.0001 par value; 1,000,000 shares authorized; 71,612 and 67,852 shares issued and outstanding at July 31, 2013 and July 31, 2012, respectively	7	7
Additional paid-in capital	381,703	309,092
Accumulated other comprehensive loss	(16)	—
Accumulated deficit	(109,274)	(80,028)
Total stockholders’ equity	272,420	229,071
Total liabilities and stockholders’ equity	$ 585,606	$ 407,804

See notes to consolidated financial statements.

PALO ALTO NETWORKS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)

	Year Ended July 31,		
	2013	2012	2011
Revenue:			
Product	$ 243,707	$ 174,462	$ 84,800
Services	152,400	80,676	33,797
Total revenue	396,107	255,138	118,597
Cost of revenue:			
Product	63,412	44,615	21,766
Services	46,344	25,938	10,507
Total cost of revenue	109,756	70,553	32,273
Total gross profit	286,351	184,585	86,324
Operating expenses:			
Research and development	62,482	38,570	21,366
Sales and marketing	199,771	115,917	62,254
General and administrative	42,719	26,207	13,108
Total operating expenses	304,972	180,694	96,728
Operating income (loss)	(18,621)	3,891	(10,404)
Interest income	484	18	3
Other expense, net	(519)	(1,110)	(1,651)
Income (loss) before income taxes	(18,656)	2,799	(12,052)
Provision for income taxes	10,590	2,062	476
Net income (loss)	$ (29,246)	$ 737	$ (12,528)
Net income (loss) attributable to common stockholders, basic and diluted	$ (29,246)	$ —	$ (12,528)
Net income (loss) per share attributable to common stockholders, basic and diluted	$ (0.43)	$ 0.00	$ (0.88)
Weighted-average shares used to compute net income (loss) per share attributable to common stockholders, basic and diluted	68,682	19,569	14,201

See notes to consolidated financial statements.

PALO ALTO NETWORKS, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(In thousands)

	Year Ended July 31,		
	2013	2012	2011
Net income (loss)	$ (29,246)	$ 737	$ (12,528)
Other comprehensive income (loss), net of tax:			
Unrealized losses on investments	(16)	—	—
Comprehensive income (loss)	$ (29,262)	$ 737	$ (12,528)

See notes to consolidated financial statements.

PALO ALTO NETWORKS, INC.

CONSOLIDATED STATEMENTS OF REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY (DEFICIT)
(In thousands)

	Redeemable Convertible Preferred Stock		Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total Stockholders' Equity (Deficit)
	Shares	Amount	Shares	Amount				
Balance as of July 31, 2010	41,084	$ 64,491	19,790	$ 2	$ 2,587	$ —	$ (68,237)	$ (65,648)
Net loss and comprehensive loss	—	—	—	—	—	—	(12,528)	(12,528)
Stock option exercises, net of unvested portion	—	—	951	—	1,094	—	—	1,094
Share-based compensation for equity based awards	—	—	—	—	4,733	—	—	4,733
Repurchase of unvested restricted common stock from terminated employees	—	—	(990)	—	—	—	—	—
Proceeds from settlement of note receivable	—	—	—	—	895	—	—	895
Balance as of July 31, 2011	41,084	64,491	19,751	2	9,309	—	(80,765)	(71,454)
Net income and comprehensive income	—	—	—	—	—	—	737	737
Conversion of redeemable convertible preferred stock into common stock upon initial public offering	(41,305)	(67,517)	41,305	4	67,513	—	—	67,517
Issuance of common stock from initial public offering, net of offering costs	—	—	5,617	1	215,374	—	—	215,375
Stock option exercises, net of unvested portion and excess tax benefit	—	—	1,044	—	2,422	—	—	2,422
Share-based compensation for equity based awards	—	—	—	—	13,837	—	—	13,837
Repurchase of unvested restricted common stock from terminated employees	—	—	(57)	—	—	—	—	—
Issuance of restricted common stock to employees	—	—	192	—	—	—	—	—
Proceeds from settlement of note receivable	—	—	—	—	637	—	—	637
Exercise of preferred stock warrants	221	3,026	—	—	—	—	—	—
Balance as of July 31, 2012	—	—	67,852	7	309,092	—	(80,028)	229,071
Net loss	—	—	—	—	—	—	(29,246)	(29,246)
Other comprehensive loss	—	—	—	—	—	(16)	—	(16)
Stock option exercises, net of unvested portion and excess tax benefit	—	—	3,627	—	22,640	—	—	22,640
Issuance of common stock upon vesting of restricted stock units	—	—	5	—	—	—	—	—
Issuance of common stock in connection with employee stock purchase plan	—	—	170	—	6,267	—	—	6,267
Share-based compensation for equity based awards	—	—	—	—	43,704	—	—	43,704
Repurchase of unvested restricted common stock from terminated employees	—	—	(42)	—	—	—	—	—
Balance as of July 31, 2013	—	$ —	71,612	$ 7	$ 381,703	$ (16)	$ (109,274)	$ 272,420

See notes to consolidated financial statements.

PALO ALTO NETWORKS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended July 31,		
	2013	2012	2011
Cash flows from operating activities			
Net income (loss)	$ (29,246)	$ 737	$ (12,528)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	9,892	6,134	2,189
Amortization of investment premiums, net of accretion of purchase discounts	1,943	—	—
Share-based compensation for equity based awards	43,704	13,837	4,733
Loss on facility sublease	262	—	—
Excess tax benefit from share-based compensation	(6,762)	(215)	—
Change in fair value of preferred stock warrants	—	958	1,577
Changes in operating assets and liabilities:			
Accounts receivable, net	(41,819)	(15,965)	(15,436)
Prepaid expenses and other assets	(8,865)	(11,063)	(5,114)
Accounts payable	5,830	3,779	2,734
Accrued and other liabilities	26,158	9,912	6,340
Deferred revenue	113,422	68,553	43,134
Reimbursement of cost of leasehold improvements	—	701	4,473
Net cash provided by operating activities	114,519	77,368	32,102
Cash flows from investing activities			
Purchase of property, equipment, and other assets	(22,442)	(14,565)	(13,000)
Purchase of investments	(345,324)	—	—
Proceeds from sales of investments	13,491	—	—
Proceeds from maturities of investments	202,710	—	—
Net cash used in investing activities	(151,565)	(14,565)	(13,000)
Cash flows from financing activities			
Proceeds from initial public offering, net of offering costs	—	215,375	—
Excess tax benefit from share-based compensation	6,762	215	—
Change in restricted cash	—	1,221	—
Proceeds from exercise of stock options	14,765	1,956	1,775
Proceeds from employee stock purchase plan	6,267	—	—
Proceeds from settlement of note receivable	—	637	895
Payments of initial public offering costs	(2,698)	—	—
Repurchase of restricted common stock from terminated employees	(78)	(82)	(90)
Net cash provided by financing activities	25,018	219,322	2,580
Net increase (decrease) in cash and cash equivalents	(12,028)	282,125	21,682
Cash and cash equivalents—beginning of period	322,642	40,517	18,835
Cash and cash equivalents—end of period	$ 310,614	$ 322,642	$ 40,517
Supplemental disclosures of cash flow information			
Cash paid for income taxes	$ 304	$ 1,355	$ 32
Cash paid for interest	$ 58	$ 23	$ 25
Non-cash investing and financing activities			
Conversion of preferred stock into common stock	$ —	$ 67,517	$ —
Issuance of preferred stock upon exercise of warrant	$ —	$ 3,026	$ —

See notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Description of Business and Summary of Significant Accounting Policies

Description of Business

Palo Alto Networks, Inc. (the "Company," "we," "us," or "our"), located in Santa Clara, California, was incorporated in March 2005 under the laws of the State of Delaware and commenced operations in April 2005. We offer a next-generation network security platform that allows enterprises, service providers, and government entities to secure their networks and safely enable the increasingly complex and rapidly growing number of applications running on their networks. The core of our platform is our Next-Generation Firewall that delivers application, user, and content visibility and control integrated within the firewall through our proprietary operating system, hardware, and software architecture. We primarily sell our products and services to end-customers through our channel partners and infrequently directly to end-customers. Our partners are supported by our sales and marketing organization in the Americas, in Europe, the Middle East, and Africa (EMEA), and in Asia Pacific and Japan (APAC).

Basis of Presentation and Consolidation

The accompanying consolidated financial statements, which include the Company and its wholly owned subsidiaries, have been prepared in conformity with U.S. generally accepted accounting principles. All significant intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Such management estimates include the best estimate of selling price for our products and services, share-based compensation, future taxable income, contract manufacturer liabilities, litigation and settlement costs and other loss contingencies, and warranty liabilities. We base our estimates on historical experience and also on assumptions that we believe are reasonable. Actual results could differ materially from those estimates.

Concentrations

Financial instruments that subject us to concentrations of credit risk consist primarily of cash, cash equivalents, investments, and accounts receivable. The Company invests only in high-quality credit instruments and maintains its cash, cash equivalents and available-for-sale investments in fixed income securities. Management believes that the financial institutions that hold our investments are financially sound and, accordingly, are subject to minimal credit risk. Deposits held with banks may exceed the amount of insurance provided on such deposits.

Our accounts receivables are primarily derived from our channel partners representing various geographical locations. We perform ongoing credit evaluations of our channel partners and generally do not require collateral on accounts receivable. We maintain an allowance for doubtful accounts for estimated potential credit losses. As of July 31, 2013, four partners represented 38%, 16%, 11%, and 11% of our gross accounts receivable. For fiscal 2013, three partners represented 30%, 20%, and 14% of our total revenue. We rely on an independent contract manufacturer to assemble all of our products and sole suppliers for a certain number of our components.

Comprehensive Income (Loss)

Comprehensive income (loss) is comprised of net income (loss) and other comprehensive income (loss). Unrealized gains and losses on available-for-sale investments are included in our other comprehensive income or loss.

Foreign Currency Transactions

The functional currency of our foreign subsidiaries is the U.S. dollar. Monetary assets and liabilities denominated in foreign currencies have been remeasured into U.S. dollars using the exchange rates in effect at the balance sheet dates. Foreign currency denominated income and expenses have been remeasured using the average exchange rates in effect during each period. Foreign currency remeasurement gains and losses and foreign currency transaction gains and losses are not significant to the financial statements.

Cash and Cash Equivalents

We consider all highly liquid investments held at financial institutions, such as commercial paper, money market funds, and other money market securities with original maturities of three months or less at date of purchase to be cash equivalents.

Fair Value of Financial Instruments

We define fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities which are required to be recorded at fair value, we consider the principal or most advantageous market in which to transact and the market-based risk. We apply fair value accounting for all financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis. The carrying amounts reported in the consolidated financial statements approximate the fair value for cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities, due to their short-term nature.

Investments

We classify our investments as available-for-sale at the time of purchase since it is our intent that these investments are available for current operations, and include these investments on our balance sheet as either short-term or long-term investments depending on their maturity. Investments not considered cash equivalents and with maturities one year or less from the consolidated balance sheet date are classified as short-term investments. Investments with maturities greater than one year from the consolidated balance sheet date are classified as long-term investments.

Investments are considered impaired when a decline in fair value is judged to be other-than-temporary. We consult with our investment managers and consider available quantitative and qualitative evidence in evaluating potential impairment of our investments on a quarterly basis. If the cost of an individual investment exceeds its fair value, we evaluate, among other factors, general market conditions, the duration and extent to which the fair value is less than cost, and our intent and ability to hold the investment. Once a decline in fair value is determined to be other-than-temporary, an impairment charge is recorded and a new cost basis in the investment is established.

Accounts Receivable

Trade accounts receivable are recorded at the invoiced amount, net of allowances for doubtful accounts. The allowance for doubtful accounts is based on our assessment of the collectability of accounts. Management regularly reviews the adequacy of the allowance for doubtful accounts by considering the age of each outstanding invoice, each partner’s expected ability to pay, and the collection history with each partner, when applicable, to determine whether a specific allowance is appropriate. Accounts receivable deemed uncollectible are charged against the allowance for doubtful accounts when identified. As of July 31, 2013 and 2012, the allowance for doubtful accounts activity was not significant.

Property and Equipment

Property and equipment are recorded at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally one to seven years. Leasehold improvements are depreciated over the shorter of the estimated useful lives of the improvements or the remaining lease term.

Impairment of Long-Lived Assets

We evaluate events and changes in circumstances that could indicate carrying amounts of long-lived assets, including property and equipment, may not be recoverable. When such events or changes in circumstances occur, we assess the recoverability of long-lived assets by determining whether or not the carrying value of such assets will be recovered through undiscounted expected future cash flows. If the total of the future undiscounted cash flows is less than the carrying amount of an asset, we record an impairment charge for the amount by which the carrying amount of the assets exceeds the fair value of the asset. Through July 31, 2013, our impairment write-down of long-lived assets was not material.

Warranties

We generally provide a one-year warranty on hardware and a three-month warranty on software. We are indemnified by our contract manufacturer for product liability claims arising out of manufacturing defects. We accrue for potential warranty claims as a component of cost of product revenues based on historical experience and other data. Accrued warranty is recorded in accrued liabilities on the consolidated balance sheets and is reviewed periodically for adequacy. To date, we have not accrued any significant costs associated with our warranty.

Contract Manufacturer Liabilities

We outsource most of our manufacturing, repair, and supply chain management operations to our independent contract manufacturer and payments to it are a significant portion of our product cost of revenues. Although we could be contractually obligated to purchase manufactured products, we generally do not own the manufactured products. Product title transfers from our independent contract manufacturer to us and immediately to our partners upon shipment. Our independent contract manufacturer assembles our products using design specifications, quality assurance programs, and standards that we establish and it procures components and assembles our products based on our demand forecasts. These forecasts represent our estimates of future demand for our products based upon historical trends and analysis from our sales and product management functions as adjusted for overall market conditions. If the actual component usage and product demand are significantly lower than forecast, we accrue for costs for contractual manufacturing commitments in excess of our forecasted demand including costs for excess components or for carrying costs incurred by our contract manufacturer. To date, we have not accrued any significant costs associated with this exposure.

Revenue Recognition

We generate revenue from the sales of hardware and software products, subscriptions, support and maintenance, and other services primarily through a direct sales force and indirect relationships with our partners.

Revenue is recognized when all of the following criteria are met:

- ***Persuasive Evidence of an Arrangement Exists.*** We rely upon non-cancelable sales agreements and purchase orders to determine the existence of an arrangement.
- ***Delivery has Occurred.*** We use shipping documents or transmissions of product or service contract registration codes to determine delivery.
- ***The Fee is Fixed or Determinable.*** We assess whether the fee is fixed or determinable based on the payment terms associated with the transaction.
- ***Collectability is Reasonably Assured.*** We assess collectability based on credit analysis and payment history.

We recognize product revenue at the time of shipment provided that all other revenue recognition criteria have been met. Our partners generally receive an order from an end-customer prior to placing an order with us. In addition, payment from our partners is not contingent on the partner’s success in sales to end-customers. Our partners generally do not stock appliances and only have limited stock rotation rights and no price protection rights. When necessary, we make certain estimates and maintain allowances for sales returns and other programs based on our historical experience. To date, these estimates have not been significant. We recognize services revenue from subscriptions and support and maintenance ratably over the contractual service period, which is typically one to five years. Other services revenue is recognized as the services are rendered and has not been significant to date.

Most of our arrangements, other than renewals of subscriptions and support and maintenance, are multiple-element arrangements with a combination of hardware, software, subscriptions, support and maintenance, and other services. Products and services generally qualify as separate units of accounting. Our hardware deliverables typically include proprietary operating system software, which together deliver the essential functionality of our products. For multiple-element arrangements, we allocate revenue to each unit of accounting based on an estimated selling price at the arrangement inception. The estimated selling price for each element is based upon the following hierarchy: vendor-specific objective evidence (VSOE) of selling price, if available, third-party evidence (TPE) of selling price, if VSOE of selling price is not available, or best estimate of selling price (BESP), if neither VSOE of selling price nor TPE of selling price are available. The total arrangement consideration is allocated to each separate unit of accounting using the relative estimated selling prices of each unit based on the aforementioned selling price hierarchy. We limit the amount of revenue recognized for delivered elements to an amount that is not contingent upon future delivery of additional products or services or meeting of any specified performance conditions.

To determine the estimated selling price in multiple-element arrangements, we establish VSOE of selling price using the prices charged for a deliverable when sold separately. If VSOE of selling price cannot be established for a deliverable, we establish TPE of selling price by evaluating similar and interchangeable competitor products or services in standalone arrangements with similarly situated partners. However, as our products contain a significant element of proprietary technology and offer substantially different features and functionality from our competitors, we are unable to obtain comparable pricing of our competitors’ products with similar functionality on a standalone basis. Therefore, we have not been able to obtain reliable evidence of TPE of selling price. If neither VSOE nor TPE of selling price can be established for a deliverable, we establish BESP primarily based on historical transaction pricing. Historical transactions are segregated based on our pricing model and our go-to-market strategy, which include factors such as type of sales channel (reseller, distributor, or end-customer), the geographies in which our products and services were sold (domestic or international), offering type (products or services), and whether or not the opportunity was identified by our sales force or by our partners. In analyzing historical transaction pricing we evaluate whether a majority of the prices charged for a product or service, as represented by a percentage of list price, fall within a reasonable range. To further support the best estimate of selling price as determined by the historical transaction pricing or when such information is unavailable, such as when there are limited sales of a new product or service, we consider the same factors we have established through our pricing model and go-to-market strategy. The determination of BESP is made through consultation with and approval by our management.

In multiple element arrangements where software deliverables are included, revenue is allocated to each separate unit of accounting for each of the non-software deliverables and to the software deliverables as a group using the relative estimated selling prices of each of the deliverables in the arrangement based on the aforementioned estimated selling price hierarchy. The arrangement consideration allocated to the software deliverables as a group is then allocated to each software deliverable using the residual method when VSOE of fair value of the undelivered items exists. Under the residual method, the amount of revenue allocated to delivered elements equals the total arrangement consideration less the aggregate fair value of any undelivered elements. In determining VSOE of fair value, we evaluate whether a substantial majority of the historical prices charged for a product or service sold on a standalone basis, as represented by a percentage of list price, fall within a reasonably narrow range. If VSOE of fair value of one or more undelivered items does not exist, revenue from the entire arrangement is deferred and recognized at the earlier of: (i) delivery of those elements or (ii) when fair value can be established unless support and maintenance is the only undelivered element, in which case, the entire arrangement fee is recognized ratably over the contractual service period.

We account for multiple agreements with a single partner as one arrangement if the contractual terms and/or substance of those agreements indicate that they may be so closely related that they are, in effect, parts of a single arrangement.

Revenues are reported net of sales taxes. Shipping charges billed to partners are included in revenues and related costs are included in cost of revenue. Sales commissions and other incremental costs to acquire contracts are also expensed as incurred. After receipt of a partner order, any amounts billed in excess of revenue recognized are recorded as deferred revenue.

Advertising Costs

Advertising costs, which are expensed and included in sales and marketing expense when incurred, were $1,808,000, $1,604,000, and $757,000 during the years ended July 31, 2013, 2012, and 2011, respectively.

Software Development Costs

Internally developed software includes enterprise-level business software that we are customizing to meet our specific operational needs. We capitalized a total of $4,877,000 and $3,226,000 during the years ended July 31, 2013 and 2012, respectively. These capitalized costs consisted of the external direct costs and the internal payroll and payroll related costs that are related to the implementation of our enterprise resource planning software system and will be amortized over a useful life of five years. Through July 31, 2013, we recognized amortization expense of $978,000.

The costs to develop software that is marketed externally have not been capitalized as we believe our current software development process is essentially completed concurrent with the establishment of technological feasibility. As such, all related software development costs are expensed as incurred and included in research and development expense on the consolidated statements of operations.

Share-Based Compensation

Compensation expense related to share-based transactions, including employee and non-employee director awards, is measured and recognized in the financial statements based on fair value on the grant date. The fair value of restricted stock units (RSUs) is based on the closing market price of our common stock on the date of grant. The fair value of option awards and purchases under the 2012 Employee Stock Purchase Plan (2012 ESPP) is estimated using the Black-Scholes option-pricing model. This model requires the input of the fair value of our common stock and that at the date of grant we determine the expected term of the award, the expected volatility of the price of our common stock, risk-free interest rates, and expected dividend yield of our common stock. The share-based compensation expense, net of forfeitures, is recognized using a straight-line basis over the requisite service periods of the awards. We estimate a forfeiture rate to calculate the share-based compensation expense for our awards. Our forfeiture rate is based on an analysis of our actual historical forfeitures.

Income Taxes

We account for income taxes using the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in our financial statements or tax returns. In addition, deferred tax assets are recorded for the future benefit of utilizing net operating losses and research and development credit carryforwards. Valuation allowances are provided when necessary to reduce deferred tax assets to the amount expected to be realized.

We apply the authoritative accounting guidance prescribing a threshold and measurement attribute for the financial recognition and measurement of a tax position taken or expected to be taken in a tax return. We recognize liabilities for uncertain tax positions based on a two-step process. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step requires us to estimate and measure the tax liability as the largest amount that is more likely than not to be realized upon ultimate settlement.

Loss Contingencies

We are subject to the possibility of various loss contingencies arising in the ordinary course of business. We consider the likelihood of loss or impairment of an asset, or the incurrence of a liability, as well as our ability to reasonably estimate the amount of loss, in determining loss contingencies. An estimated loss contingency is accrued when it is probable that an asset has been impaired or a liability has been incurred and the amount of loss can be reasonably estimated. If we determine that a loss is possible and the range of the loss can be reasonably determined, then we disclose the range of the possible loss. We regularly evaluate current information available to us to determine whether an accrual is required, an accrual should be adjusted or a range of possible loss should be disclosed.

Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2011-05, *Presentation of Comprehensive Income.* The standard requires entities to have more detailed reporting of comprehensive income. The guidance was effective for us in the first quarter of fiscal 2013 and applied retrospectively. Our adoption of this guidance did not impact our consolidated financial position, results of operations, or cash flows.

In February 2013, the FASB issued Accounting Standards Update No. 2013-02, *Comprehensive Income (Topic 220)-Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*. The standard requires entities to present (either on the face of the income statement or in the notes) the effects on the line items of the income statement for amounts reclassified out of accumulated other comprehensive income. The guidance is effective for us in the first quarter of fiscal 2014 and should be applied prospectively. Early adoption is permitted. We believe that adoption of this guidance will not have a material impact on our consolidated financial position, results of operations, or cash flows.

2. Fair Value Measurements

We categorize assets and liabilities recorded at fair value on our consolidated balance sheets based upon the level of judgment associated with inputs used to measure their fair value. The categories are as follows:

- Level 1—Inputs are unadjusted quoted prices in active markets for identical assets or liabilities.
- Level 2—Inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the assets or liabilities, either directly or indirectly through market corroboration, for substantially the full term of the financial instruments.
- Level 3—Inputs are unobservable inputs based on our own assumptions used to measure assets and liabilities at fair value. The inputs require significant management judgment or estimation.

The following table presents the fair value of our financial assets and liabilities using the above input categories (in thousands):

	July 31, 2013				July 31, 2012			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Cash equivalents:								
Certificates of deposit	$ 1,822	$ —	$ —	$ 1,822	$ —	$ —	$ —	$ —
U.S. government and agency securities	—	46,700	—	46,700	—	—	—	—
Money market funds	131,845	—	—	131,845	250,005	—	—	250,005
Total cash equivalents	133,667	46,700	—	180,367	250,005	—	—	250,005
Short-term investments:								
Corporate debt securities	—	32,834	—	32,834	—	—	—	—
U.S. government and agency securities	—	76,173	—	76,173	—	—	—	—
Total short-term investments	—	109,007	—	109,007	—	—	—	—
Long-term investments:								
Corporate debt securities	—	12,317	—	12,317	—	—	—	—
U.S. government and agency securities	—	4,997	—	4,997	—	—	—	—
Total long-term investments	—	17,314	—	17,314	—	—	—	—
Other assets:								
Restricted cash	1,221	—	—	1,221	1,221	—	—	1,221
Total other assets	1,221	—	—	1,221	1,221	—	—	1,221
Total assets measured at fair value	$ 134,888	$ 173,021	$ —	$ 307,909	$ 251,226	$ —	$ —	$ 251,226

3. Investments

The following table summarizes the unrealized gains and losses and fair value of our investments designated as available-for-sale securities as of July 31, 2013 (in thousands):

	July 31, 2013			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Certificates of deposit	$ 1,822	$ —	$ —	$ 1,822
Corporate debt securities	45,173	12	(34)	45,151
U.S. government and agency securities	127,864	8	(2)	127,870
Money market funds	131,845	—	—	131,845
Total	$ 306,704	$ 20	$ (36)	$ 306,688

The following table presents our available-for-sale investments that were in an unrealized loss position as of July 31, 2013 (in thousands):

	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Corporate debt securities	$ 31,429	$ (34)	$ —	$ —	$ 31,429	$ (34)
U.S. government and agency securities	15,926	(2)	—	—	15,926	(2)
Total	$ 47,355	$ (36)	$ —	$ —	$ 47,355	$ (36)

Unrealized losses related to these investments are due to interest rate fluctuations as opposed to changes in credit quality. In addition, we do not intend to sell and it is not more likely than not that we would be required to sell these investments before recovery of their amortized cost basis, which may be at maturity. As a result, there is no other-than-temporary impairment for these investments at July 31, 2013.

The amortized cost and fair value of our investments at July 31, 2013, by contractual years-to-maturity, are as follows (in thousands):

	Amortized Cost	Fair Value
Due within one year	$ 157,515	$ 157,529
Due within one to two years	17,344	17,314
Instruments not due at a single maturity date	131,845	131,845
Total	$ 306,704	$ 306,688

4. Intangible Assets

Intangible assets included in other assets consisted of the following (in thousands):

	July 31,	
	2013	2012
Acquired intellectual property	$ 1,546	$ 546
Less: amortization	(188)	(63)
Total	$ 1,358	$ 483

Amortization expense was $125,000, $39,000 and $12,000 for the years ended July 31, 2013, 2012 and 2011, respectively.

The following table summarizes estimated future amortization expense of intangible assets as of July 31, 2013 (in thousands):

	Amount
Years ending July 31:	
2014	$ 227
2015	227
2016	227
2017	208
2018	110
2019 and thereafter	359
Total	$ 1,358

5. Other Financial Information

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

	July 31,			
	2013		2012	
Computers, equipment, and software	$	27,239	$	12,016
Demonstration units		11,401		8,440
Leasehold improvements		10,176		8,913
Furniture and fixtures		2,746		2,436
Total property and equipment		51,562		31,805
Less: accumulated depreciation and amortization		(19,476)		(10,826)
Total property and equipment, net	$	32,086	$	20,979

Depreciation and amortization expense related to property and equipment during the years ended July 31, 2013, 2012 and 2011 was $9,786,000, $6,057,000, and $2,167,000, respectively.

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

	July 31,			
	2013		2012	
Accrued expenses payable	$	11,144	$	11,497
Accrued taxes		2,609		1,168
Other liabilities		856		2,524
Total accrued and other liabilities	$	14,609	$	15,189

6. Commitments and Contingencies

Leases

We lease our facilities under various non-cancelable operating leases, which expire through the year ending July 31, 2023.

In September 2012, we entered into two lease agreements for an aggregate of approximately 300,000 square feet of space in Santa Clara, California to serve as our new corporate headquarters beginning in November 2013. The leases have inception dates of November 2012 and August 2013, expire in July 2023, and allow for two separate five-year options to extend the lease term. Payments under these leases will be approximately $94,400,000 over the lease term. Each lease has a rent holiday, which was included in the determination of rent expense.

In July 2013, we entered into a 51-month sub-lease agreement for our current corporate headquarters with a lease inception date of January 2014. Payments under this sub-lease will be approximately $10,700,000 over the lease term. The sub-lease agreement contains a rent credit of $524,000, which was included in the determination of rental income.

Rent expense was $4,356,000, $2,258,000, and $1,393,000 for the years ended July 31, 2013, 2012 and 2011, respectively. Rent expense is recognized using the straight-line method over the term of the lease.

The aggregate future non-cancelable minimum rental payments on our operating leases, as of July 31, 2013, are as follows (in thousands):

	Amount	
Years ending July 31:		
2014	$	7,728
2015		12,152
2016		12,482
2017		12,224
2018		11,427
2019 and thereafter		52,300
Committed gross lease payments		108,313
Less: proceeds from sublease rental		(10,700)
Net operating lease obligation	$	97,613

Contract Manufacturer Commitments

Our independent contract manufacturer procures components and assembles our products based on our forecasts. These forecasts are based on estimates of future demand for our products, which are in turn based on historical trends and an analysis from our sales and product marketing organizations, adjusted for overall market conditions. In order to reduce manufacturing lead times and plan for adequate supply, we may issue forecasts and orders for components and products that are non-cancelable. Obligations under contracts that we can cancel without a significant penalty are not included. As of July 31, 2013, we had $19,130,000 of open orders.

Litigation

In December 2011, Juniper Networks, Inc. filed a complaint against us in the United States District Court for the District of Delaware alleging patent infringement. The complaint seeks preliminary and permanent injunctions against infringement, treble damages, and attorney’s fees. On February 9, 2012, we filed a response to the complaint, which denied all claims and asserted that the claimant’s patents were invalid. On February 28, 2012, Juniper filed a motion to strike our defense of invalidity based on the legal doctrine of “assignor estoppel.” On March 23, 2012, we filed a brief in opposition to that motion. Juniper filed a brief in response on April 2, 2012. On August 2, 2012, the District Court issued an order granting Juniper’s motion as to one of the patents in suit (the ’634 patent) but denying Juniper’s motion as to the five other patents in suit. On September 4, 2012, Juniper filed a motion to amend its complaint to allege that our appliances infringe two additional U.S. patents but also to withdraw its allegations as to a previously-asserted patent. This amended complaint was officially filed on September 25, 2012, pursuant to a stipulation between the parties. Juniper now alleges that our appliances infringe seven of its patents. On September 13, 2012, we filed with the U.S. Patent and Trademark Office requests for *inter partes* reexamination of five of the six patents asserted by Juniper in its original complaint. We did not file a request for reexamination on the withdrawn patent. On October 12, 2012, we filed an answer to Juniper’s amended complaint, which denied that we infringed Juniper’s patents and asserted that Juniper’s patents were invalid. On October 19 and December 3, 2012, the U.S. Patent and Trademark Office granted our requests for reexamination for three patents, rejecting a number of the claims asserted in the litigation, and on November 15 and 26, 2012, the U.S. Patent and Trademark Office denied our requests for reexamination as to two other patents. We have the opportunity to seek review of these denials within the U.S. Patent and Trademark Office. Each party served its opening expert report on April 12, 2013, and rebuttal expert report on May 13, 2013, and supplemental expert reports on June 11, 2013. The parties filed opening and responsive briefs regarding claim construction, filed their opening summary judgment briefs on August 20, 2013, and filed opposition briefs and additional summary judgment motions on September 12, 2013. On June 20, 2013 and July 23, 2013, we filed with the U.S. Patent and Trademark Office petitions for *inter partes* review for two other patents asserted by Juniper in the litigation. The Patent and Trademark Office has not yet ruled on those petitions. A hearing to resolve claim construction issues, as well as motions for summary judgment, is scheduled to be heard on November 15, 2013.

A trial date has been scheduled for February 24, 2014, and we are vigorously defending ourselves from such claims. At this stage in the litigation we do not believe that a loss is probable and we are unable to estimate a possible loss or range of possible loss.

In addition to the above matter, 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. We have made an assessment of the probability of incurring any such losses and whether or not those losses are estimable.

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.

Indemnification

Under the indemnification provisions of our standard sales related contracts, we agree to defend our end-customers against third-party claims asserting infringement of certain intellectual property rights, which may include patents, copyrights, trademarks, or trade secrets, and to pay judgments entered on such claims. Our exposure under these indemnification provisions is generally limited to the total amount paid by our end-customer under the agreement. However, certain agreements include indemnification provisions that could potentially expose us to losses in excess of the amount received under the agreement. In addition, we indemnify our officers, directors, and certain key employees while they are serving in good faith in their company capacities. To date, there have been no claims under any indemnification provisions.

7. Stockholders’ Equity (Deficit)

In July 2012, we completed our initial public offering whereby 6,200,000 shares of common stock were sold to the public at a price of $42.00 per share. We sold 4,687,000 common shares and selling stockholders sold 1,513,000 common shares. In connection with the exercise of the underwriters' over-allotment option, 930,000 additional shares of common stock were sold to the public at the initial offering price of $42.00 per share. We received aggregate proceeds of $219,400,000 from the initial public offering and the underwriters' over-allotment option, net of underwriters' discounts and commissions, but before deducting offering expenses of approximately $4,000,000. As of July 31, 2012 unpaid offering expenses have been accrued against the proceeds and are presented as a reduction of proceeds from our initial public offering, net of offering costs in the consolidated financial statements. Upon the closing of the initial public offering, all shares of our outstanding redeemable convertible preferred stock automatically converted into 41,305,000 shares of common stock.

In October 2012, we completed our secondary offering whereby certain stockholders of our company sold 4,800,000 shares of common stock to the public at a price of $63.00 per share. The aggregate offering price for shares sold in the offering was approximately $290,304,000, net of underwriting discounts and commissions. We did not receive any proceeds from the sale of shares in this offering. Offering expenses were paid by the stockholders who sold shares of common stock in the offering.

8. Equity Award Plans

Share-Based Compensation Plans

2012 Equity Incentive Plan

Our 2012 Equity Incentive Plan (2012 Plan) was adopted by our board of directors and approved by the stockholders on June 5, 2012 and was effective one business day prior to the effectiveness of our registration statement for our initial public offering. The 2012 Plan replaced our 2005 Equity Incentive Plan (2005 Plan). Our 2012 Plan provides for the granting of stock options, restricted stock awards, RSUs, stock appreciation rights, performance units, and performance shares to our employees, directors, and consultants.

Awards granted under our 2012 Plan vest over the periods determined by the board of directors, generally four years, and expire no more than ten years after the date of grant. In the case of an incentive stock option granted to an employee, who at the time of grant, owns stock representing more than 10% of the total combined voting power of all classes of stock, the exercise price shall be no less than 110% of the fair value per share on the date of grant, and expire five years from the date of grant, and for options granted to any other employee, the per share exercise price shall be no less than 100% of the fair value per share on the date of grant. In the case of a non-statutory stock option and options granted to consultants, the per share exercise price shall be no less than 100% of the fair value per share on the date of grant. Stock that is purchased prior to vesting is subject to our right of repurchase at any time following termination of the participant.

RSUs generally vest over a period of three to four years from the date of grant. Until vested, RSUs do not have the voting and dividend participation rights of common stock and the shares underlying the awards are not considered issued and outstanding.

A total of 21,205,000 shares of our common stock are reserved for issuance pursuant to the 2012 Plan and includes shares that are (i) reserved but unissued under the 2005 Plan on the effective date of the 2012 Plan or (ii) returned to our 2005 Plan as a result of expiration or termination of options. On the first day of each fiscal year, starting with August 1, 2013, the number of shares in the reserve will increase by the lesser of (i) 8,000,000 shares, (ii) 4.5% of the outstanding shares of common stock on the last day of our immediately preceding fiscal year, or (iii) such other amount as determined by our board of directors.

2012 Employee Stock Purchase Plan

Our 2012 ESPP 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.

The 2012 ESPP permits eligible employees to acquire shares of our common stock at 85% of the lower of the fair market value of our common stock on the first trading day of each offering period or on the exercise date. Each offering period will be approximately six months starting on the first trading date on or after March 15 and September 15 of each year, except for the first offering period, which commenced on July 19, 2012 and ended on March 15, 2013. Participants may purchase shares of common stock through payroll deductions of up to 15% of their eligible compensation, subject to purchase limits of 625 shares during a six month period or $25,000 worth of stock for each calendar year.

A total of 829,000 shares of our common stock are available for sale under the 2012 ESPP as of July 31, 2013. On the first day of each fiscal year, starting with August 1, 2013, the number of shares in the reserve will increase by the lesser of (i) 2,000,000 shares,

(ii) 1% of the outstanding shares of our common stock on the first day of the fiscal year, or (iii) such other amount as determined by our board of directors.

2005 Plan

Our 2005 Plan was terminated upon the completion of our initial public offering. Awards that were outstanding upon termination remained outstanding pursuant to their original terms.

Stock Option Activities

A summary of the activity under our stock plans and changes during the reporting periods and a summary of information related to options exercisable, vested, and expected to vest are presented below (in thousands, except per share amounts):

	Options Outstanding			
	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Balance—July 31, 2012	14,225	$ 9.46	8.3	$ 678,248
Options granted	90	55.36		
Options forfeited	(655)	10.71		
Options exercised	(3,627)	4.07		
Balance—July 31, 2013	10,033	11.74	7.8	$ 373,228
Options vested and expected to vest—July 31, 2013	9,589	$ 11.55	7.8	$ 358,533
Options exercisable—July 31, 2013	5,125	$ 8.06	7.4	$ 209,510

The weighted-average fair value of employee options granted for the years ended July 31, 2013, 2012 and 2011 was $26.09, $8.17, and $2.90, respectively. The intrinsic value of employee options exercised for the years ended July 31, 2013, 2012 and 2011 was $186,845,000, $20,334,000, and $3,854,000, respectively. The grant date fair value of employee options vested for the years ended July 31, 2013, 2012 and 2011 was $21,351,000, $6,960,000, and $1,777,000, respectively.

RSUs Activities

A summary of the activity under our stock plans and changes during the reporting periods and a summary of information related to RSUs vested and expected to vest are presented below (in thousands, except per share amounts):

	RSUs Outstanding			
	Number of Shares	Weighted-Average Grant-Date Fair Value Per Share	Weighted-Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Balance—July 31, 2012	—	$ —	0.0	$ —
RSUs granted	2,358	54.51		
RSUs vested	(5)	49.25		
RSUs forfeited	(112)	57.89		
Balance—July 31, 2013	2,241	$ 54.36	1.5	$ 109,675
RSUs vested and expected to vest—July 31, 2013	2,011	$ 54.44	1.5	$ 98,418

Shares Available for Grant

The following table presents the stock activity and the total number of shares available for grant as of July 31, 2013 (in thousands):

	Number of shares
Balance at beginning of fiscal year	10,571
Options granted	(90)
RSUs granted	(2,358)
Repurchased	42
Options forfeited	655
RSUs forfeited	112
Balance at end of fiscal year	8,932

Employee Stock Purchase Plan

During the years ended July 31, 2013 and 2012, compensation expense recognized in connection with the 2012 Employee Stock Purchase Plan (2012 ESPP) was $5,263,000 and $172,000, respectively. Employees purchased approximately 170,000 shares of common stock at an average exercise price of $36.72 during the year ended July 31, 2013.

Share-Based Compensation

We record share-based compensation awards based on fair value as of the grant date. For option awards and ESPP purchases we use the Black-Scholes option-pricing model to determine fair value. We recognize such costs to compensation expense on a straight-line basis over the employee's requisite service period. The assumptions for our option-pricing model are determined as follows:

Fair Value of Common Stock

Prior to our initial public offering, our board of directors considered numerous objective and subjective factors to determine the fair value of our common stock at each meeting at which awards were approved. These factors included, but were not limited to (i) contemporaneous third-party valuations of common stock; (ii) the rights and preferences of convertible preferred stock relative to common stock; (iii) the lack of marketability of common stock; (iv) developments in the business; and (v) the likelihood of achieving a liquidity event, such as an initial public offering or sale of the Company, given prevailing market conditions.

Risk-Free Interest Rate

We base the risk-free interest rate used in the Black-Scholes valuation model on the implied yield available on U.S. Treasury zero-coupon issues with an equivalent remaining term of the options for each option group.

Expected Term

The expected term represents the period that our share-based awards are expected to be outstanding. We determined the expected term assumption based on the contractual term of the awards adjusted for estimates of our employees' expected exercise and expected post-vesting termination behavior.

Volatility

We determine the price volatility factor based on the historical volatilities of our peer group as we do not have sufficient trading history for our common stock.

Dividend Yield

The expected dividend assumption is based on our current expectations about our anticipated dividend policy.

The following table summarizes the assumptions relating to our stock options:

	Year Ended July 31,		
	2013	2012	2011
Risk-free interest rate	1.0%	0.7% - 1.1%	0.8% - 1.8%
Expected term	6 years	4 – 6 years	4 years
Volatility	50%	49% – 51%	49%
Dividend yield	—%	—%	—%

The following table summarizes the assumptions related to the 2012 ESPP:

	Year Ended July 31,	
	2013	2012
Risk-free interest rate	0.1%	0.1%
Expected term	< 1 year	< 1 year
Volatility	42%	46%
Dividend yield	—%	—%

Share-based compensation expense is included in costs and expenses as follows (in thousands):

	Year Ended July 31,		
	2013	2012	2011
Cost of revenue	$ 4,351	$ 774	$ 206
Research and development	9,931	3,733	1,020
Sales and marketing	20,493	4,267	1,133
General and administrative	9,101	5,151	2,374
Total	$ 43,876	$ 13,925	$ 4,733

For fiscal 2013, we modified the terms of certain share-based awards for a former employee and as a result, we recorded $1,861,000 of compensation expense within sales and marketing expense.

For fiscal 2012, we modified the terms of certain share-based awards for a former employee and as a result, we recorded $854,000 of compensation expense within research and development expense.

For fiscal 2011, we modified the terms of certain share-based awards for a former employee and as a result, we recorded $1,626,000 of compensation expense within general and administrative expense.

At July 31, 2013, total compensation cost related to unvested share-based awards granted to employees under our stock plans but not yet recognized was $133,563,000, net of estimated forfeitures. This cost is expected to be amortized on a straight-line basis over a weighted-average period of three years. Future grants will increase the amount of compensation expense to be recorded in these periods.

9. Income Taxes

Income (loss) before provision for income taxes consisted of the following (in thousands):

	Year Ended July 31,		
	2013	2012	2011
United States	$ 5,198	$ 1,646	$ (12,654)
Foreign	(23,854)	1,153	602
Total	$ (18,656)	$ 2,799	$ (12,052)

The provision for income taxes consisted of the following (in thousands):

	Year Ended July 31,		
	2013	2012	2011
Federal:			
Current	$ 5,883	$ 525	$ —
Deferred	—	—	—
State:			
Current	1,758	647	24
Deferred	—	—	—
Foreign:			
Current	3,296	861	490
Deferred	(347)	29	(38)
Total	$ 10,590	$ 2,062	$ 476

The items accounting for the difference between income taxes computed at the federal statutory income tax rate and the provision for income taxes consisted of the following:

	Year Ended July 31,		
	2013	2012	2011
Federal statutory rate	35.0 %	34.0%	34.0 %
Effect of:			
State taxes, net of federal tax benefit	1.0	9.7	4.6
Change in valuation allowance	(7.3)	(85.4)	(26.9)
Foreign income at other than U.S. rates	(62.4)	17.2	(1.8)
Share-based compensation	(16.1)	66.6	(6.9)
Preferred stock warrant liability	—	12.3	(5.0)
Meals and entertainment	(2.0)	11.9	(1.5)
Other, net	(5.0)	7.4	(0.4)
Total	(56.8)%	73.7%	(3.9)%

The components of the deferred tax assets and liabilities are as follows (in thousands):

	July 31,	
	2013	2012
Deferred tax assets:		
Accruals and reserves	$ 23,461	$ 12,065
Research and development and foreign tax credits	4,702	3,911
Net operating loss carryforwards	2,170	10,632
Share-based compensation	10,619	2,956
Gross deferred tax assets	40,952	29,564
Valuation allowance	(37,659)	(29,555)
Total deferred tax assets	3,293	9
Deferred tax liabilities	(2,937)	—
Total	$ 356	$ 9

A valuation allowance is provided when it is more likely than not that the deferred tax asset will not be realized. Realization of the deferred tax assets is dependent upon future taxable income, if any, the amount and timing of which are uncertain. At such time, if it is determined that it is more likely than not that the deferred tax assets are realizable, the valuation allowance will be adjusted. As of July 31, 2013, we have provided a valuation allowance for our federal and state deferred tax assets that we believe are more likely than not unrealizable. The net valuation allowance increased by approximately $8,104,000 during fiscal 2013. As of July 31, 2013, we had federal and state net operating loss carryforwards of approximately nil and $37,363,000, respectively, available to reduce future taxable income, if any. If not utilized, the state net operating loss carryforwards will begin to expire from the years ending July 31, 2017 through 2030.

We also have federal and state research and development tax credit carryforwards of approximately $100,000 and $4,577,000, respectively. If not utilized, the federal credit carryforwards will expire in various amounts from the years ended July 31, 2026 through 2033. The state credit will carry forward indefinitely.

Utilization of the net operating loss carryforwards and credits may be subject to a substantial annual limitation due to the ownership change limitations provided by the Internal Revenue Code of 1986, as amended, and similar state provisions. The annual limitation may result in the expiration of net operating losses and credits before utilization.

We use the with-and-without approach described in guidance which has been incorporated into ASC 740 *Income Taxes* to determine the recognition and measurement of excess tax benefits. Accordingly, we have elected to recognize excess income tax benefits from share-based awards in additional paid-in capital only if an incremental income tax benefit would be realized after considering all other tax attributes presently available to us. As of July 31, 2013, the amount of excess tax benefits from stock options included in federal and state net operating losses is $63,915,000 and $112,377,000, respectively. The impact of this excess tax benefit is recognized as additional paid-in capital when it reduces taxes payable. In addition, we have elected to account for the indirect effects of share-based awards on other tax attributes, such as the research, foreign and other tax credits, through the consolidated statement of operations.

As of July 31, 2013, we had $6,561,000 of unrecognized tax benefits, all of which would affect income tax expense if recognized, before consideration of our valuation allowance. As of July 31, 2013, our federal, state, and foreign returns for the tax years 2008 through the current period are still open to examination. We do not expect the unrecognized tax benefits to change significantly over the next 12 months. We recognize both interest and penalties associated with uncertain tax positions as a component of income tax expense. As of July 31, 2013 and 2012, we recognized interest and penalties of $294,000 and $72,000, respectively. The ultimate amount and timing of any future cash settlements cannot be predicted with reasonable certainty.

A reconciliation of the gross unrecognized tax benefit is as follows (in thousands):

	Year Ended July 31,		
	2013	2012	2011
Unrecognized tax benefits at the beginning of the period	$ 2,630	$ 1,972	$ 1,061
Additions for tax positions taken in prior years	585	9	320
Reductions for tax positions taken in prior years	(3)	—	—
Additions for tax positions related to the current year	3,349	649	591
Settlements	—	—	—
Lapse of statute of limitations	—	—	—
Unrecognized tax benefits at the end of the period	$ 6,561	$ 2,630	$ 1,972

As of July 31, 2013, we have not made any tax provision for U.S. federal and state income taxes on approximately $5,208,000 of undistributed earnings in foreign subsidiaries, which we expect to reinvest outside of the U.S. indefinitely. If we were to repatriate these earnings to the U.S., we would be subject to U.S. income taxes, an adjustment for foreign tax credits, and foreign withholding taxes. The amount of unrecognized deferred tax liability was not significant.

10. Net Income (Loss) Per Share

We compute net income (loss) per share of common stock using the two-class method required for participating securities. Immediately prior to the completion of our initial public offering on July 19, 2012, all shares of outstanding redeemable convertible preferred stock were automatically converted to common stock. Prior to their conversion, we considered all series of our redeemable convertible preferred stock to be participating securities as the holders were entitled to participate in common stock dividends with common stock on an as-converted basis. The holders of our redeemable convertible preferred stock were also entitled to non-cumulative dividends prior and in preference to common stock and did not have a contractual obligation to share in the losses of the Company. Additionally, we consider shares issued upon the early exercise of options subject to repurchase and unvested restricted shares to be participating securities because holders of such shares have non-forfeitable dividend rights in the event of our declaration of a dividend for common shares. In accordance with the two-class method, earnings allocated to these participating securities, which include participation rights in undistributed earnings with common stock, are subtracted from net income to determine net income (loss) attributable to common stockholders.

Basic net income (loss) per common share is computed by dividing net income (loss) attributable to common stockholders by basic weighted-average shares outstanding during the period. All participating securities are excluded from basic weighted-average shares outstanding. In computing diluted net income (loss) attributable to common stockholders, undistributed earnings are re-allocated to reflect the potential impact of dilutive securities. Diluted net income (loss) per share attributable to common stockholders is computed by dividing net income (loss) attributable to common stockholders by diluted weighted-average shares outstanding, including potentially dilutive securities.

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

	Year Ended July 31,		
	2013	2012	2011
Net income (loss) used to compute net income (loss) per share:			
Net income (loss)	$ (29,246)	$ 737	$ (12,528)
Less: undistributed earnings allocated to participating securities	—	(737)	—
Net income (loss) attributable to common stockholders, basic and diluted	$ (29,246)	$ —	$ (12,528)
Weighted-average shares used to compute net income (loss) per share attributable to common stockholders:			
Weighted-average shares used to compute net income (loss) per share attributable to common stockholders, basic and diluted	68,682	19,569	14,201
Net income (loss) per share attributable to common stockholders, basic and diluted	$ (0.43)	$ 0.00	$ (0.88)

The following outstanding options, RSUs, ESPP shares, warrants to purchase redeemable convertible preferred stock, and redeemable convertible preferred stock were excluded from the computation of diluted net income (loss) per common share applicable to common stockholders for the periods presented as their effect would have been antidilutive (in thousands):

	Year Ended July 31,		
	2013	2012	2011
Options	10,033	4,116	8,195
RSUs	2,241	—	—
ESPP shares	114	—	—
Redeemable convertible preferred stock	—	—	41,084
Warrants to purchase redeemable convertible preferred stock	—	—	225

11. Employee Benefit Plan

We have established a 401(k) tax - deferred savings plan (401(k) Plan) which permits participants to make contributions by salary deduction pursuant to Section 401(k) of the Internal Revenue Code. We are responsible for administrative costs of the 401(k) Plan and have made no contributions to the 401(k) Plan since inception.

12. Segment Information

We conduct business globally and are primarily managed on a geographic theater basis. Our chief operating decision maker reviews financial information presented on a consolidated basis accompanied by information about revenue by geographic region for purposes of allocating resources and evaluating financial performance. We have one business activity and there are no segment managers who are held accountable for operations, operating results, and plans for levels, components, or types of products or services below the consolidated unit level. Accordingly, we are considered to be in a single reportable segment and operating unit structure.

Revenue by geographic theater based on the billing address of the partner is as follows (in thousands):

	Year Ended July 31,		
	2013	2012	2011
Revenue:			
Americas			
United States	$ 228,604	$ 151,435	$ 69,696
Other Americas	19,012	10,438	3,449
Total Americas	247,616	161,873	73,145
EMEA	91,496	61,994	32,504
APAC	56,995	31,271	12,948
Total revenue	$ 396,107	$ 255,138	$ 118,597

Substantially all of our assets were attributable to the Americas operations as of July 31, 2013 and 2012.

13. Related Party Transactions

Certain members of our board of directors serve as board members or executive officers of certain of our customers and in some cases are also investors of these customers. We believe these transactions with related party customers are carried out on terms that are consistent with similar transactions with our comparable customers. During the year ended July 31, 2013, we recognized revenue of approximately $2,623,000 from sales transactions with significant related party customers. Amounts payable to and due from related party customers were not material at July 31, 2013. We did not have any material sales transactions with related party customers in the year ended July 31, 2012 or 2011.

14. Selected Quarterly Financial Data (Unaudited)

The following tables set forth selected unaudited financial data for the years ended July 31, 2013 and 2012 (in thousands, except per share amounts):

	Three Months Ended			
	Oct. 31, 2012	Jan. 31, 2013	Apr. 30, 2013	Jul. 31, 2013
Revenue:				
Product	$ 55,514	$ 61,944	$ 60,793	$ 65,456
Services	30,420	34,555	40,496	46,929
Total revenue	85,934	96,499	101,289	112,385
Cost of revenue:				
Product	14,416	16,636	15,855	16,505
Services	9,774	10,982	11,835	13,753
Total cost of revenue	24,190	27,618	27,690	30,258
Total gross profit	61,744	68,881	73,599	82,127
Operating expenses:				
Research and development	13,312	15,495	16,048	17,627
Sales and marketing	42,607	45,796	51,733	59,635
General and administrative	8,956	9,747	12,268	11,748
Total operating expenses	64,875	71,038	80,049	89,010
Operating loss	(3,131)	(2,157)	(6,450)	(6,883)
Interest income	98	116	133	137
Other expense, net	(170)	(60)	(157)	(132)
Loss before income taxes	(3,203)	(2,101)	(6,474)	(6,878)
Provision for income taxes	312	512	808	8,958
Net loss	$ (3,515)	$ (2,613)	$ (7,282)	$ (15,836)
Net loss per share attributable to common stockholders:				
Basic	$ (0.05)	$ (0.04)	$ (0.10)	$ (0.22)
Diluted	$ (0.05)	$ (0.04)	$ (0.10)	$ (0.22)

	Three Months Ended			
	Oct. 31, 2011	Jan. 31, 2012	Apr. 30, 2012	Jul. 31, 2012
Revenue:				
Product	$ 42,861	$ 38,638	$ 43,524	$ 49,439
Services	14,252	18,045	22,176	26,203
Total revenue	57,113	56,683	65,700	75,642
Cost of revenue:				
Product	10,310	10,248	11,524	12,533
Services	4,530	5,265	7,109	9,034
Total cost of revenue	14,840	15,513	18,633	21,567
Total gross profit	42,273	41,170	47,067	54,075
Operating expenses:				
Research and development	7,848	8,514	10,462	11,746
Sales and marketing	22,368	25,612	30,216	37,721
General and administrative	5,157	5,768	6,430	8,852
Total operating expenses	35,373	39,894	47,108	58,319
Operating income (loss)	6,900	1,276	(41)	(4,244)
Interest income	2	2	3	11
Other expense, net	(464)	(566)	(3)	(77)
Income (loss) before income taxes	6,438	712	(41)	(4,310)
Provision (benefit) for income taxes	2,322	288	(837)	289
Net income (loss)	$ 4,116	$ 424	$ 796	$ (4,599)
Net income (loss) per share attributable to common stockholders:				
Basic	$ 0.00	$ 0.00	$ 0.00	$ (0.18)
Diluted	$ 0.00	$ 0.00	$ 0.00	$ (0.18)

15. Subsequent Events

In September 2013 we purchased intangible assets for $5,000,000.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Based on our evaluation, our chief executive officer and chief financial officer concluded that, as of July 31, 2013, our disclosure controls and procedures are designed at a reasonable assurance level and are effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Management's Annual Report on Internal Control Over Financial Reporting

For the "Management's Annual Report on Internal Control over Financial Reporting" see the report under Item 8 of Part II of this Annual Report on Form 10-K, which report is incorporated herein by reference.

For the "Report of Independent Registered Public Accounting Firm," see the report under Item 8 of Part II of this Annual Report on Form 10-K, which report is incorporated herein by reference.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the quarter ended July 31, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Executive Officers and Directors

Information required by this Item is incorporated herein by reference to the sections entitled “Executive Officers,” “Proposal No. 1—Election of Directors,” “Board of Directors and Corporate Governance” and “Other Matters” in our definitive proxy statement with respect to our 2013 Annual Meeting of Stockholders to be filed with the SEC within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

ITEM 11. EXECUTIVE COMPENSATION

Information required by this Item is incorporated herein by reference to the section entitled "Executive Compensation" and "Board of Directors and Corporate Governance—Non-Employee Director Compensation" in our definitive proxy statement with respect to our 2013 Annual Meeting of Stockholders to be filed with the SEC within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT RELATED STOCKHOLDER MATTERS

Information required by this Item is incorporated herein by reference to the sections entitled "Security Ownership of Certain Beneficial Owners and Management," and "Executive Compensation—Equity Compensation Plan Information" in our definitive proxy statement with respect to our 2013 Annual Meeting of Stockholders to be filed with the SEC within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Information required by this Item is incorporated herein by reference to the sections entitled "Related Party Transactions" and "Board of Directors and Corporate Governance—Director Independence" in our definitive proxy statement with respect to our 2013 Annual Meeting of Stockholders to be filed with the SEC within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Information required by this Item is incorporated herein by reference to the section entitled "Proposal No. 2 — Ratification of Appointment of Independent Registered Public Accounting Firm" in our definitive proxy statement with respect to our 2013 Annual Meeting of Stockholders to be filed with the SEC within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

Documents filed as part of this Annual Report on Form 10-K are as follows:

1. Consolidated Financial Statements:

Our Consolidated Financial Statements are listed in the “Index to Consolidated Financial Statements” under Part II, Item 8 of this Annual Report on Form 10-K.

2. Financial Statement Schedules:

Financial statement schedules have been omitted because they are not required, not applicable, not present in amounts sufficient to require submission of the schedule, or the required information is shown in the Consolidated Financial Statements or Notes thereto.

3. Exhibits

The documents listed in the Exhibit Index of this Annual Report on Form 10-K are incorporated by reference or are filed with this Annual Report on Form 10-K, in each case as indicated therein (numbered in accordance with Item 601 of Regulation S-K).

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities and Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on September 24, 2013.

PALO ALTO NETWORKS, INC.

By: /s/ MARK D. MCLAUGHLIN

Mark D. McLaughlin

Chief Executive Officer and President

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Mark D. McLaughlin and Steffan C. Tomlinson, and each of them, as his true and lawful attorney-in-fact and agent, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments (including post-effective amendments) to this Annual Report on Form 10-K, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or any of them, or their or his substitutes, may lawfully do or cause to be done by virtue thereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Company and in the capacities and on the dates indicated:

Signature	Title	Date
/s/ MARK D. MCLAUGHLIN Mark D. McLaughlin	Chief Executive Officer, President and Director, (Principal Executive Officer)	September 24, 2013
/s/ STEFFAN C. TOMLINSON Steffan C. Tomlinson	Chief Financial Officer (Principal Accounting and Financial Officer)	September 24, 2013
/s/ NIR ZUK Nir Zuk	Chief Technical Officer and Director	September 24, 2013
/s/ ASHEEM CHANDNA Asheem Chandna	Director	September 24, 2013
/s/ JOHN M. DONOVAN John M. Donovan	Director	September 24, 2013
/s/ CARL ESCHENBACH Carl Eschenbach	Director	September 24, 2013
/s/ JAMES J. GOETZ James J. Goetz	Director	September 24, 2013
/s/ CHARLES J. ROBEL Charles J. Robel	Director	September 24, 2013
/s/ DANIEL J. WARMENHOVEN Daniel J. Warmenhoven	Director	September 24, 2013

EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference Form	File No.	Exhibit	Filing Date
3.1	Restated Certificate of Incorporation of the Registrant.	10-K	001-35594	3.1	October 4, 2012
3.2	Amended and Restated Bylaws of the Registrant.	10-K	001-35594	3.2	October 4, 2012
10.1*	Form of Indemnification Agreement between the Registrant and its directors and officers.	S-1/A	333-180620	10.1	July 9, 2012
10.2*	2005 Equity Incentive Plan and related form agreements under 2005 Equity Incentive Plan.	S-1/A	333-180620	10.2	July 9, 2012
10.3*	2012 Equity Incentive Plan and related form agreements under 2012 Equity Incentive Plan.	S-1/A	333-180620	10.3	July 9, 2012
10.4*	2012 Employee Stock Purchase Plan and related form agreements under 2012 Employee Stock Purchase Plan.	S-8	333-182762	99.3	July 20, 2012
10.5*	Employee Incentive Compensation Plan.	10-K	001-35594	10.16	October 4, 2012
10.6*	Offer Letter between the Registrant and Mark D. McLaughlin, dated July 21, 2011, as amended.	S-1	333-180620	10.6	April 6, 2012
10.7*	Offer Letter between the Registrant and Steffan C. Tomlinson, dated January 17, 2012.	S-1	333-180620	10.7	April 6, 2012
10.8*	Letter Agreement between the Registrant and Nir Zuk, dated December 19, 2011.	S-1	333-180620	10.8	April 6, 2012
10.9*	Letter Agreement between the Registrant and Rajiv Batra, dated December 19, 2011.	S-1	333-180620	10.9	April 6, 2012
10.10*	Letter Agreement between the Registrant and René Bonvanie, dated December 19, 2011.	S-1	333-180620	10.10	April 6, 2012
10.11*	Offer Letter between the Registrant and Charles J. Robel, dated June 9, 2011.	S-1	333-180620	10.12	April 6, 2012
10.12*	Offer Letter between the Registrant and Daniel J. Warmenhoven, dated February 14, 2012.	S-1	333-180620	10.13	April 6, 2012
10.13*	Offer Letter between the Registrant and Mark F. Anderson, dated May 23, 2012.	S-1/A	333-180620	10.16	July 9, 2012
10.14*	Offer Letter between the Registrant and John M. Donovan, dated September 14, 2012	8-K	001-35594	10.1	September 20, 2012
10.15*	Offer Letter between the Registrant and Carl Eschenbach, dated May 9, 2013.	8-K	001-35594	10.1	May 30, 2013
10.16	Lease between the Registrant and Santa Clara Office Partners LLC, dated October 20, 2010, as amended.	S-1	333-180620	10.14	April 6, 2012
10.17	Amendment No. 2 to Lease between the Registrant and Santa Clara Office Partners LLC, dated July 2, 2013.				
10.18	Lease between the Registrant and SI 34 LLC, dated September 17, 2012	10-K	001-35594	10.16	October 4, 2012
10.19	Lease between the Registrant and SI 34 LLC, dated September 17, 2012	10-K	001-35594	10.16	October 4, 2012
10.20**	Manufacturing Services Agreement between the Registrant and Flextronics Telecom Systems Ltd., dated September 20, 2010.	S-1	333-180620	10.15	April 6, 2012

Exhibit Number	Exhibit Description	Incorporated by Reference			
		Form	File No.	Exhibit	Filing Date
10.21*	Amendment to Restricted Stock Agreement, dated as of March 8, 2013, by and between the Company and Nir Zuk.	8-K	001-35594	10.1	March 11, 2013
10.22*	Amendment to Restricted Stock Agreement, dated as of March 8, 2013, by and between the Company and Rajiv Batra.	8-K	001-35594	10.2	March 11, 2013
21.1	List of subsidiaries of the Registrant				
23.1	Consent of Independent Registered Public Accounting Firm				
24.1	Power of Attorney (contained in the signature page to this Annual Report on Form 10-K)				
31.1	Certification of the Chief Executive Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.				
31.2	Certification of the Chief Financial Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.				
32.1†	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.				
32.2†	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.				
101.INS††	XBRL Instance Document.				
101.SCH††	XBRL Taxonomy Schema Linkbase Document.				
101.CAL††	XBRL Taxonomy Calculation Linkbase Document.				
101.DEF††	XBRL Taxonomy Definition Linkbase Document.				
101.LAB††	XBRL Taxonomy Labels Linkbase Document.				
101.PRE††	XBRL Taxonomy Presentation Linkbase Document.				

* Indicates a management contract or compensatory plan or arrangement.

** Registrant has omitted portions of the relevant exhibit and filed such exhibit separately with the Securities and Exchange Commission pursuant to a request for confidential treatment under Rule 406 under the Securities Act of 1933, as amended.

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

†† XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is otherwise not subject to liability under these sections.

Exhibit 10.17

AMENDMENT NO. 2 TO LEASE

This AMENDMENT NO. 2 TO LEASE (this “Amendment”) is entered into as of July 2, 2013, by and between SANTA CLARA OFFICE PARTNERS LLC, a Delaware limited liability company (“Landlord”), on the one hand, and PALO ALTO NETWORKS, INC., a Delaware corporation (“Tenant”), on the other hand, with reference to the following facts:

R E C I T A L S

A. Landlord and Tenant are parties to that certain Lease dated as of October 20, 2010, as amended by that certain Amendment No. 1 to Lease dated as of March __, 2011 [original undated] and executed by Landlord on April 12, 2011 (collectively, the “Lease”), concerning certain premises located at 3300 Olcott Street in Santa Clara, California.

B. Capitalized terms used but not defined in this Amendment shall have the meanings assigned to them in the Lease.

C. Tenant desires to sublease the entirety of the Leased Premises to Gigamon Inc., a Delaware corporation (“Subtenant”), pursuant to a Sublease in the precise form of **Exhibit A** attached to this Amendment (the “Sublease”). Pursuant to the Lease, Landlord’s consent is required in order for Tenant and Subtenant to enter into the Sublease.

D. Landlord is willing to consent to such Sublease, on the terms and conditions set forth in this Amendment.

A G R E E M E N T

NOW, THEREFORE, in consideration of the foregoing Recitals, the mutual covenants and agreements contained herein, and further good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Landlord and Tenant hereby agree as follows:

1. **Conditions.** The following conditions must be satisfied or waived in writing by Landlord; if any such condition is neither satisfied nor so waived, then at Landlord’s option in its sole discretion, this Amendment shall be deemed null and void and of no force or effect. The conditions are:

(a) the full execution and delivery of the Sublease by Tenant and Subtenant, and the delivery to Landlord of one fully-executed original thereof;

(b) the execution and delivery of this Amendment by Landlord and Tenant; and

(c) the satisfaction or written waiver by Landlord of the condition set forth in Section 7 below; and

(d) the full execution and delivery of a Consent to Sublease in the precise form of **Exhibit B** attached to this Amendment (the “Consent to Sublease”).

2. **Base Monthly Rent**. Upon satisfaction or written waiver by Landlord of the foregoing conditions, Article 1 of the Lease is hereby amended by replacing the definition of “Base Monthly Rent” therein with the following:

Base Monthly Rent: The term “Base Monthly Rent” shall mean the following:

Period:	Base Monthly Rent:
4/1/11 – 3/31/12	$0
4/1/12 – 3/31/13	$124,000.00
4/1/13 – 9/30/13	$128,000.00
10/1/13 – 6/30/14	$0
7/1/14 – 12/31/14	$235,630.72
1/1/15 – 12/31/15	$243,027.20
1/1/16 – 12/31/16	$250,423.68
1/1/17 – 12/31/17	$257,820.16
1/1/18 – 3/31/18	$265,216.64

3. **No Assignment Consideration or Sublease Profits**. Landlord and Tenant acknowledge and agree that there is no assignment consideration or sublease profits resulting from the Sublease.

4. **Mutual Waiver of Subrogation**. Paragraph 9.3 of the Lease is hereby amended in its entirety to read as follows:

Notwithstanding anything to the contrary in this Lease, Landlord hereby releases Tenant and its respective partners, principals, shareholders, members, shareholders, officers, agents, employees and servants, and Tenant hereby releases Landlord and its respective partners, principals, members, shareholders, officers, agents, employees and servants, from any and all liability for loss, damage or injury to the property of the other in or about the Leased Premises or the Property which is caused by or results from any risk insured against under any property insurance policy actually carried or required to be carried by any such parties under this Lease. Each party shall cause each insurance policy obtained by it to provide that the insurer waives all right of recovery against the other party and its agents and employees in connection with any damage or injury covered by the policy.

5. **Notices.** Paragraph 13.10 of the Lease is hereby amended in its entirety to read as follows:

Any notice required or permitted to be given under this Lease other than statutory notices shall be in writing and (i) personally delivered, (ii) sent by United States mail, registered or certified mail, postage prepaid, return receipt requested, (iii) sent by Federal Express or similar nationally recognized overnight courier service, or (iv) transmitted by facsimile with a hard copy sent within one (1) business day by any of the foregoing means, and in all cases addressed as follows, and such notice shall be deemed to have been given upon the date of actual receipt or delivery (or refusal to accept delivery) at the address specified below (or such other addresses as may be specified by notice in the foregoing manner) as indicated on the return receipt or air bill:

If to Landlord: Santa Clara Office Partners LLC
c/o Menlo Equities LLC
490 California Avenue
4th Floor
Palo Alto, California 94306
Attention: Henry Bullock/Richard Holmstrom
Facsimile: (650) 326-9333

with a copy to: Mintz Levin Cohn Ferris Glovsky and Popeo PC
44 Montgomery Street
36th Floor
San Francisco, California 94104
Attention: Paul Churchill

Facsimile: (415) 432-6001

If to Tenant: Palo Alto Networks, Inc.
3300 Olcott Street
Santa Clara, California 95054
Attention: General Counsel
Facsimile: (408) 753-4001

Any notice given in accordance with the foregoing shall be deemed received upon actual receipt or refusal to accept delivery. Any notice required by statute and not waived in this Lease shall be given and deemed received in accordance with the applicable statute or as otherwise provided by law.

6. **Options to Extend**. Upon satisfaction or written waiver by Landlord of the foregoing conditions, Landlord and Tenant agree that Tenant shall no longer have any options to extend the Term of the Lease and that the Lease is hereby amended by deleting Article 15, effective upon such satisfaction or written waiver by Landlord of the foregoing conditions.

7. **Additional Condition Precedent To Lease Amendment**. The effectiveness of this Amendment and Landlord's and Tenant's obligations hereunder are subject to the receipt by Landlord, no later than ten (10) business days after the date hereof, of the Lender's Consent. Landlord hereby agrees to use diligent efforts to obtain the Lender's Consent by such date; however, if Landlord does not receive the Lender's Consent by such date, this Amendment shall, at either Landlord's or Tenant's option by written notice to the other party delivered prior to receipt of Lender's Consent (if received after such 10-business-day period), thereupon be deemed terminated and of no further force or effect, and neither party shall have any further rights, obligations, or liabilities hereunder. As used herein, the term "Lender's Consent" means a written consent to this Amendment in form reasonably satisfactory to Landlord and Tenant, executed by the holder of the promissory note secured by that certain Construction Deed of Trust, Assignment of Rents and Leases, Security Agreement and Fixture Filing (encumbering the fee interest in the real property of which the Leased Premises are a part), recorded on April 9, 2008 in the Official Records of Santa Clara, California, at Series No. 19806764, as amended.

8. **Option Term Lease; Restoration of Certain Alterations**.

(a) In the Consent to Sublease, Landlord has granted Subtenant the option to lease the Leased Premises directly from Landlord pursuant to the Option Term Lease (as defined in the Consent to Sublease) at the expiration of the Term of the Lease. In the event that Subtenant exercises such option and becomes a direct tenant of Landlord's pursuant to the Option Term Lease, or in the event Landlord, in its sole and absolute discretion, agrees to enter into a different form of direct lease with Subtenant for the entirety of the Leased Premises commencing concurrently with the expiration of the Lease (an "Alternative Direct Lease"), Landlord agrees that (i) Tenant shall be excused from the removal and restoration and other surrender obligations set forth in Paragraph 2.6 of the Lease and (ii) such obligations shall be deferred to the expiration or earlier termination of the Option Term Lease or the Alternative Direct Lease, as applicable, in both cases (i) and (ii), if but only to the extent that Subtenant has assumed such obligations in accordance with Section 3 of the Consent to Sublease. Tenant acknowledges and agrees that Landlord shall have no obligation to enter into the Alternative Direct Lease, and may refuse to do so for any reason or no reason.

(b) Landlord agrees that, notwithstanding Section 8(a) above, Article 6 of the Lease, and the four (4) letters attached to this Amendment as **Exhibit C** (the "Alteration Approval Letters"), Landlord will not require Tenant or Subtenant to remove the Alterations which were the subject of the Alteration Approval Letters.

9. **Brokers.** Tenant represents, warrants and agrees that it has not had any dealings with any real estate broker(s), leasing agent(s), finder(s) or salesmen, other than Cooper/Brady Partnership dba

Cresa ("Cresa") with respect to the Sublease, and that it will indemnify, defend with competent counsel approved by Landlord, and hold Landlord harmless from any liability for the payment of any real estate brokerage commissions, leasing commissions or finder's fees claimed by any other real estate broker(s), leasing agent(s), finder(s), or salesmen to be earned or due and payable by reason of Tenant's agreement or promise (implied or otherwise) to pay (or to have Landlord pay) such a commission or finder's fee by reason of the Sublease. In reliance on the foregoing, Landlord shall pay a leasing commission to Cresa on account of this Lease Amendment and the Sublease in the aggregate amount of $919,325 pursuant to, in accordance with, and subject to the conditions contained in, a separate written agreement signed by Landlord and Cresa.

(c) **Successors and Assigns**. This Amendment shall be binding upon any and all of the administrators, executors, successors, trustors, beneficiaries and assigns of each of the parties without regard to the time at which said persons first assumed such status. Landlord's interest in this Amendment shall be freely assignable by Landlord in its sole discretion.

(d) **Multiple Counterparts**. This Amendment may be executed in multiple counterparts, each of which shall constitute an original. The parties contemplate that the executed counterparts of this Amendment may be transmitted by facsimile and agree and intend that a signature sent by facsimile machine shall bind the party so signing with the same effect as though the signature were an original signature.

(e) **Advice of Counsel**. The parties acknowledge that they have been represented in the negotiations for and in the performance of this Amendment by counsel of their own choice; that they have read this Amendment; that they have had this Amendment fully explained to them by such counsel or have had such opportunity; and that they are fully aware of the contents of this Amendment and of its legal effect.

(f) **Attorneys' Fees**. In the event of any dispute, claim or litigation based upon, arising out of, or relating to, the breach or enforcement of any of the provisions of this Amendment, the prevailing party in such dispute, claim or litigation shall be entitled to recover attorneys' fees, costs and expenses from the non-prevailing party.

(g) **Choice of Law**. This Amendment shall be construed and enforced in accordance with California law.

(h) **Construction**. The Amendment shall not be construed as if drafted by only one party, but shall be construed as if drafted by both parties.

(i) **Authority**. Each party represents to the other that it has the right to enter into this Amendment, and that it is not violating the terms or conditions of any other agreement to which it is a party or by which it is bound by entering into this Amendment. It is further represented and agreed that the individuals signing this Amendment on behalf of the respective parties do have actual authority to execute this Amendment and, by doing so, bind the party on whose behalf this Amendment has been signed.

IN WITNESS WHEREOF, the parties have executed this Amendment effective as of the date first set forth above.

LANDLORD:

SANTA CLARA OFFICE PARTNERS LLC,
a Delaware limited liability company

By: Menlo Equities III LLC,
a California limited liability company,
its Managing Member

By: Menlo Equities LLC,

a California limited liability company,
its Managing Member

By: Diamant Investments LLC,
a Delaware limited liability company,
its Member

By: /s/ Rick Holmstrom
Rick Holmstrom, Manager

TENANT:

PALO ALTO NETWORKS, INC., a
Delaware corporation

By: /s/ Jeffrey C. True
Jeffrey C. True, VP & General Counsel

EXHIBIT A

SUBLEASE

[FOLLOWING THIS PAGE]

SUBLEASE

THIS SUBLEASE (this "Sublease") is dated for reference purposes as of July 2, 2013, and is made by and between PALO ALTO NETWORKS, INC., a Delaware corporation ("Sublessor"), and GIGAMON INC, a Delaware corporation ("Sublessee"). Sublessor and Sublessee hereby agree as follows:

1. Recitals: This Sublease is made with reference to the fact that Santa Clara Office Partners LLC, as landlord ("Master Lessor"), and Sublessor, as tenant, entered into that certain lease, dated as of October 20, 2010, as amended by that certain Amendment No. 1 to Lease dated as of March __, 2011 [original undated] (the "First Amendment to Master Lease") and that certain Amendment No. 2 to Lease dated as of the date hereof (as amended, the "Master Lease"), with respect to premises consisting of approximately 105,664 square feet of space located at 3300 Olcott Street, Santa Clara, California (the "Premises"). A copy of the Master Lease is attached hereto as Exhibit A.

2. Premises: Sublessor hereby subleases to Sublessee, and Sublessee hereby subleases from Sublessor, the entire Premises (hereinafter, the "Subleased Premises").

3. Term:

A. Term. The term (the "Term") of this Sublease shall be for the period commencing on the later of (i) January 1, 2014 or (ii) the date Sublessor delivers possession of the Subleased Premises professionally cleaned and free of occupancy by Sublessee's employees and any personal property of Sublessor, other than the Furniture (as defined below) (the "Commencement Date") and ending on March 31, 2018 (the "Expiration Date"), unless this Sublease is sooner terminated pursuant to its terms or the Master Lease is sooner terminated pursuant to its terms.

B. Early Access. Sublessor shall permit Sublessee to access the Subleased Premises no later than December 14, 2013 (the "Delivery Date"), for the purpose of installing its furniture, fixtures, voice and data communications systems and any other improvements or equipment necessary for the conduct of Sublessee's business, subject to Sublessor's receipt of Master Lessor's consent to this Sublease and all of the insurance certificates required of Sublessee under this Sublease. Such occupancy (i) shall be subject to all of the applicable provisions of this Sublease, specifically excluding the obligation to pay Rent (as defined below) but including the obligation to pay utilities; and (ii) shall not advance the Expiration Date of this Sublease. Sublessor and Sublessee acknowledge that, during Sublessee's early access period prior to the Commencement Date, Sublessor's employees and contractors may have access to the Subleased Premises for purposes of causing them to be professionally cleaned and in the required delivery condition. Sublessor and Sublessee shall cooperate with each other during such early access period to minimize interference with each party's activities.

C. No Option to Extend. The parties hereby acknowledge that the expiration date of the Master Lease is March 31, 2018 and that Sublessee has no option to extend the Term of this Sublease. Sublessor shall use its best efforts to request Master Landlord grant Sublessee an option to renew. Provided that this Sublease has not been terminated due to a default by Sublessee, Sublessor waives any right it may have to extend the term of the Master Lease, including, without limitation, Sublessor's extension option rights under Article 15 of the Master Lease.

4. Rent:

A. Base Rent. The monthly base rent schedule ("Base Rent") shall be as follows:

Months	Rate / sf	Base Rent
1-6	$2.23	$0.00
7-12	$2.23	$235,630.72
13-24	$2.30	$243,027.20
25-36	$2.37	$250,423.68
37-48	$2.44	$257,820.16
49-51	$2.51	$265,216.64

Notwithstanding the foregoing, Sublessor hereby agrees to provide Sublessee with an additional credit against Base Rent in the amount of $528,320 ($5.00 per rentable square foot of the Subleased Premises), which shall automatically be applied against Base Rent first due commencing on the first day of the seventh (7th) month of the Term, until such credit is exhausted. Base Rent and Additional Rent, as defined below, shall be paid on or before the first (1st) day of each month. Base Rent and Additional Rent for any period during the Term hereof which is for less than one (1) month of the Term shall be a pro rata portion of the monthly installment based on a thirty (30) day month. Base Rent and Additional Rent shall be payable without notice or demand and, except as otherwise provided in this Sublease, without any deduction, offset, or abatement, in lawful money of the United States of America. Rent shall be paid directly to Sublessor at 4401 Great America Parkway, Santa Clara, CA 95054, Attention: Corporate Controller or such other address as may be designated in writing by Sublessor. Upon execution hereof by Sublessee and Sublessor, Sublessee shall pay to Sublessor the sum of Two Hundred Thirty-Five Thousand Six Hundred Thirty and 72/100 Dollars ($235,630.72), which shall be applied as a credit against the first installment(s) of Base Rent due under this Sublease.

B. Additional Rent. All monies other than Base Rent required to be paid by Sublessor under the Master Lease, including, without limitation, any amounts payable by Sublessor to Master Lessor as "Property Operating Expenses" (as defined in Section 3.2 of the Master Lease, as incorporated herein) and payment of any business property taxes on the Furniture (defined below) with respect to the Term, shall be paid by Sublessee hereunder as and when such amounts are due hereunder. All such amounts shall be deemed additional rent ("Additional Rent"). Base Rent and Additional Rent hereinafter collectively shall be referred to as "Rent". Notwithstanding anything to the contrary contained in this Sublease, (i) Sublessee shall not be required to pay any Rent that is due as a result of any default by Sublessor (through no fault of Sublessee) of any of Sublessor’s obligations under the Master Lease and (ii) in no event shall Sublessee be liable or responsible to Sublessor for any costs, claims, demands or liabilities to the extent arising from (a) any default by Sublessor in the performance of its obligations under Section 4.11 of the Master Lease prior to the Commencement Date or (b) any Hazardous Materials that were first introduced to the Premises or Property prior to the Commencement Date through no fault of Sublessee or any of its agents, contractors, employees or invitees.

5. Late Charge: If Sublessee fails to pay to Sublessor any amount due hereunder within five (5) days after the due date, Sublessee shall pay Sublessor upon demand a late charge equal to five percent (5%) of the delinquent amount accruing from the due date. In addition, Sublessee shall pay to Sublessor interest on all amounts due, at the rate identified in Section 3.4 of the Master Lease, as incorporated herein (the "Interest Rate"), from the due date to and including the date of the payment. The parties agree that the foregoing late charge represents a reasonable estimate of the cost and expense which Sublessor will incur in processing each delinquent payment. Sublessor's acceptance of any interest or late charge shall not waive Sublessee's default in failing to pay the delinquent amount. Notwithstanding the foregoing, no late charge or interest shall be due on the first (and only the first) late payment of Rent by Sublessee during any twelve (12) month period during the Term unless Sublessee fails to make such payment to Sublessor within five (5) days after Sublessee’s receipt of a written notice of delinquency from Sublessor.

6. Security Deposit: Upon execution hereof by Sublessee, Sublessee shall deposit with Sublessor the sum of Two Hundred Eighty-One Thousand Sixty-Six and 24/100 Dollars ($281,066.24) (the “Security Deposit”), in cash, as security for the performance by Sublessee of the terms and conditions of this Sublease. The Security Deposit shall be held in accordance with the terms of Section 3.7 of the Master Lease, as incorporated herein.

7. Holdover: The parties hereby acknowledge that the expiration date of the Master Lease is March 31, 2018 and that it is therefore critical that Sublessee surrender the Subleased Premises to Sublessor no later than the Expiration Date in accordance with the terms of this Sublease. In the event that Sublessee does not surrender the Subleased Premises by the Expiration Date in accordance with Paragraph 19 hereof, Sublessee shall indemnify, defend, protect and hold harmless Sublessor from and against all loss and liability resulting from Sublessee's delay in surrendering the Subleased Premises and pay Sublessor holdover rent as provided in Section 13.2 of the Master Lease.

8. Delivery and Acceptance:

A. No later than the Delivery Date, Sublessor shall deliver possession of the Subleased Premises to Sublessee in their current configuration free of any employees of or personal property of Sublessor other than the Furniture (as defined below), and, Sublessor shall cause the Subleased Premises to be professionally cleaned no later than the Commencement Date. If Sublessor fails to deliver possession of the Subleased Premises to Sublessee for early access in the required condition on or before the Delivery Date or fails to cause the Commencement Date to occur by January 1, 2014 for any reason whatsoever, then this Sublease shall not be void or voidable, nor shall Sublessor be liable to Sublessee for any loss or damage; provided, however, that (i) in such event, Sublessee shall receive one (1) day of free Rent for each day after (y) the Delivery Date until Sublessor delivers possession of the Subleased Premises in the condition required on the Delivery Date and (z) January 1, 2014 until the Commencement Date occurs, with such "free Rent" not to exceed in the aggregate forty-five (45) days. In addition, if the Commencement Date does not occur by February 28, 2014, then Sublessee may terminate this Sublease by delivery of written notice to Sublessor of such termination not later than March 10, 2014, whereupon this Sublease shall terminate (unless possession is delivered prior to Sublessor's receipt of such termination notice) and Sublessor shall promptly refund to Sublessee the Security Deposit and prepaid Base Rent paid by Sublessee to Sublessor under this Sublease.

B. Notwithstanding the foregoing, Sublessor represents and warrants, to Sublessor's actual knowledge, that the Subleased Premises will be delivered in watertight condition in their current configuration, in compliance with applicable law and with all operating systems serving the Subleased Premises in good operating condition and repair. Except to the extent caused by the acts or omissions of Sublessee or its agents, employees, or contractors or by any alterations or improvements by Sublessee, if Sublessee delivers to Sublessor written notice specifying a breach of the foregoing responsibilities within sixty (60) days after the Commencement Date, Sublessor shall be responsible for repairing or correcting the same; provided, however, that with respect to repairs that are the obligation of Master Lessor under the Master Lease, Sublessor's obligations with respect to such repairs shall be limited as set forth in Paragraph 28 below. If Sublessor fails to perform its obligations under this Paragraph 8.B, then, Sublessee shall have the right to perform such obligations to the extent provided in Paragraph 27 below, but subject to the notice and cure periods set forth therein.

9. Repairs: The parties acknowledge and agree that Sublessee is subleasing the Subleased Premises on an "as is" basis, except as otherwise expressly provided in this Sublease, and that Sublessor has made no representations or warranties with respect to the condition of the Subleased Premises except as expressly provided in this Sublease. Except as otherwise provided in Paragraph 8 above, Sublessor shall have no obligation whatsoever to make or pay the cost of any alterations, improvements or repairs to the Subleased Premises, including, without limitation, any improvement or repair required to comply with any law, regulation, building code or ordinance (including the Americans with Disabilities Act of 1990). Master Lessor shall be solely responsible for performance of any repairs required to be performed by Master Lessor under the terms of the Master Lease.

10. Indemnity: Except to the extent caused by the negligence or willful misconduct of, or any violation of law (through no fault of Sublessee) by, Sublessor, its agents, employees, contractors or invitees, Sublessee shall indemnify, defend with counsel reasonably acceptable to Sublessor, protect and hold Sublessor harmless from and against any and all claims, liabilities, judgments, causes of action, damages, costs and expenses (including reasonable attorneys' and experts' fees) ("Claims"), to the extent caused by or arising in connection with: (i) the use or occupancy of the Subleased Premises by Sublessee; (ii) the negligence or willful misconduct of Sublessee or its employees, contractors, agents or invitees; or (iii) a breach of Sublessee's obligations under this Sublease or the provisions of the Master Lease that have been incorporated into this Sublease as obligations of Sublessee. Sublessee's indemnification of Sublessor shall survive termination of this Sublease. In addition,

Sublessor shall indemnify, defend with counsel reasonably acceptable to Sublessee, protect and hold Sublessee harmless from and against any and all Claims to the extent caused by or arising in connection with the use or release of Hazardous Materials by Sublessor or its agents, employees and contractors at the Subleased Premises in violation of applicable environmental laws.

11. Right to Cure Defaults: If Sublessee fails to pay any sum of money under this Sublease, or fails to perform any other act on its part to be performed hereunder, then Sublessor may, but shall not be obligated to, after passage of any applicable notice and cure periods, make such payment or perform such act. All such sums paid, and all reasonable costs and expenses of performing any such act, shall be deemed Additional Rent payable by Sublessee to Sublessor upon demand, together with interest thereon at the Interest Rate from the date of the expenditure until repaid.

12. Assignment and Subletting. Sublessee may not assign this Sublease, sublet the Subleased Premises, transfer any interest of Sublessee therein or permit any use of the Subleased Premises by another party (collectively, “Transfer”), without the prior written consent of Sublessor (which consent shall be conditioned upon the receipt of Master Lessor’s consent, but otherwise, Sublessor’s consent shall not be unreasonably withheld, conditioned or delayed) and Master Lessor to the extent required under the Master Lease. Any Transfer without such consent shall be void and, at the option of Sublessor, shall terminate this Sublease. Sublessor's waiver or consent to any assignment or subletting shall be ineffective unless set forth in writing, and Sublessee shall not be relieved from any of its obligations under this Sublease unless the consent expressly so provides. Any Transfer shall be subject to the terms of Article 7 of the Master Lease. Notwithstanding the foregoing, as between Sublessor and Sublessee only (and without limiting the rights of Master Lessor under the Sublease or Sublessee’s obligations abide by the provisions and restrictions of Article 7 of the Master Lease, including, without limitation, the obligation to contain the consent of Master Lessor to the extent provided in the Master Lease), Sublessor agrees that: (i) none of the following shall constitute a Transfer: any change in the controlling ownership interest of the entity that constitutes Sublessee which results from any of the following: (a) the infusion of additional equity capital in Sublessee or an initial public offering of equity securities of Sublessee under the Securities Act of 1933, as amended, which results in Sublessee's stock being traded on a national securities exchange, including, but not limited to, the NYSE, the NASDAQ Stock Market or the NASDAQ Small Cap Market System (a “National Exchange”); or (b) any transfer or sale of the stock or other ownership interest in Sublessee (1) to the spouse(s) and/or children of a shareholder of Sublessee, (2) to any trust, the beneficiary(ies) of which are family members of a shareholder of Sublessee, (3) by reason of bequest or inheritance, or (4) in connection with the issuance of warrants or stock options to purchase Sublessee’s stock, and the exercise of any purchase rights under any such warrants or stock options; provided, that any such issuance or exercise does not result in a change in the controlling percentage (as defined in the Master Lease) of the stock or other equity interests of Sublessee; and (ii) Sublessee may assign this Sublease or sublet the Subleased Premises, without any “recapture right” by Sublessor and without any obligation to pay to Sublessor “assignment consideration” or “excess rentals” (as such terms are defined in the Master Lease) to any entity (i) controlling, controlled by or having fifty percent (50%) or more common control with Sublessee, or (ii) resulting from a merger, non-bankruptcy reorganization or consolidation with Sublessee or acquiring substantially all of the assets and/or substantially all of the stock of Sublessee; provided that (w) any such entity shall assume the obligations and liabilities of Sublessee under this Sublease (or such of such obligations and liabilities as are to be performed by the sublessee under the terms of the applicable sublease in the event of a sublease), and no such assignment or sublease shall in any manner release Sublessee from its primary liability under this Sublease, (x) any such entity has a net worth at the time of such assignment or sublease that is sufficient to undertake the financial obligations under this Sublease and at least equal to that of Sublessee immediately before the merger, acquisition or other transaction, (y) Sublessee provides Sublessor with at least ten (10) days prior written notice of such transaction (or within ten [10] days after such transaction if Sublessee is prevented by law or any bona fide confidentiality agreement from providing prior notice to Sublessor) together with such information reasonably required by Sublessor that establishes that the underlying transaction complies with the provisions of this sentence and (z) Sublessee is not in monetary or material non-monetary default under the Sublease beyond applicable notice and cure periods at the time of the proposed Transfer.

13. Use: Sublessee may use the Subleased Premises only for the uses identified in Article 4 of the Master Lease. Sublessee shall comply with all reasonable rules and regulations promulgated from time to time by Master Lessor under the Master Lease.

14. Effect of Conveyance: As used in this Sublease, the term “Sublessor” means the holder of the tenant’s interest under the Master Lease. In the event of any assignment, transfer or termination of the tenant’s

interest under the Master Lease, which assignment, transfer or termination may occur at any time during the Term hereof in Sublessor's sole discretion (but only so long as (i) any such termination does not result in a breach of Sublessor's obligations under this Sublease and (ii) any assignment does not result in a termination of this Sublease due to the exercise of any recapture right by Master Lessor under the Master Lease), Sublessor shall be and hereby is entirely relieved of all covenants and obligations of Sublessor hereunder first accruing after the date of such transfer, provided that the transferee has assumed and agreed in writing and shall carry out all covenants and obligations thereafter to be performed by Sublessor hereunder. Sublessor shall transfer and deliver any security of Sublessee to the transferee of the tenant's interest under the Master Lease, and thereupon Sublessor shall be discharged from any further liability with respect thereto.

15. Improvements: No alteration or improvements shall be made to the Subleased Premises, except in accordance with the Master Lease, and with the prior written consent of both Master Lessor and Sublessor (which consent shall not be unreasonably withheld, conditioned or delayed) in accordance with this Sublease. Notwithstanding the foregoing, Sublessor conceptually approves Sublessee's construction of the improvements to the Subleased Premises described on Exhibit E attached hereto and made a part hereof, provided that such improvements are constructed in accordance with Article 6 of the Master Lease. The foregoing approval by Sublessor does not waive any obligation of Sublessee to obtain Master Lessor consent to such improvements or constitute a waiver of Sublessor's remaining rights with respect to the review and approval of such improvements, such as approval over plans and specifications and determination of restoration obligations.

16. Release and Waiver of Subrogation: Notwithstanding anything to the contrary in this Sublease, Sublessor and Sublessee hereby release each other from any damage to property or loss of any kind which is caused by or results from any risk insured against under any property insurance policy actually carried or required to be carried by any such parties under this Sublease or the Master Lease. Each party shall cause each insurance policy obtained by it to provide that the insurer waives all right of recovery against the other party and its agents and employees in connection with any damage or injury covered by the policy. Sublessor shall not be liable to Sublessee, nor shall Sublessee be entitled to terminate this Sublease or to abate Rent (except if and to the extent Sublessor is allowed a proportionate abatement of Rent under the Master Lease) for any: (i) failure or interruption of any utility system or service; (ii) failure of Master Lessor to maintain the Subleased Premises as may be required under the Master Lease; or (iii) penetration of water into or onto any portion of the Subleased Premises. The obligations of Sublessor and Sublessee under this Sublease shall not constitute the personal obligations of the officers, directors, trustees, partners, joint venturers, members, owners, stockholders or other principals or representatives of either business entity.

17. Insurance: Sublessee shall obtain and keep in full force and effect, at Sublessee's sole cost and expense, during the Term the insurance required under Section 9.1 of the Master Lease. Sublessee shall name Master Lessor and Sublessor as additional insureds under its liability insurance policy.

18. Default; Remedies: Sublessee shall be in material default of its obligations under this Sublease upon the occurrence of any of the "Events of Default" set forth in Section 12.1 of the Master Lease, as incorporated herein. In the event of any Event of Default by Sublessee, Sublessor shall have all remedies provided pursuant to Section 12.2 of the Master Lease and by applicable law. Sublessor may resort to its remedies cumulatively or in the alternative.

19. Surrender: Prior to expiration of this Sublease, Sublessee shall remove all of its trade fixtures and shall surrender the Subleased Premises to Sublessor in the condition existing upon the delivery of possession of the Subleased Premises to Sublessee, free of hazardous materials caused by Sublessee and in the condition required by Section 2.6 the Master Lease (provided, however, that Sublessee shall not be required to remove or restore any alterations or improvements to the Premises made by or on behalf of Sublessor other than the basketball court installed by Sublessor in the parking area, but only if and to the extent such removal is required by Master Lessor under the Second Amendment to Master Lease), reasonable wear and tear, any alterations or improvements to the Subleased Premises made and paid for by Sublessee during the Term that Master Lessor agrees may be surrendered at the expiration of the Term, and damage caused by casualty or condemnation excepted. If the Subleased Premises are not so surrendered, then Sublessee shall be liable to Sublessor for all costs incurred by Sublessor in returning the Subleased Premises to the required condition, plus interest thereon at the Interest Rate. Notwithstanding the foregoing, if Sublessee has entered into a direct lease with Master Lessor (including, without limitation, pursuant to the exercise of Sublessee's rights pursuant to Section 19 of the Master Lessor Consent (as defined below)) commencing concurrently with the expiration of the Term of this Sublease, Sublessee's obligations to surrender

possession of the Subleased Premises in the condition required under this Sublease on the Expiration Date shall be excused.

20. Broker: Sublessor and Sublessee each represent to the other that they have dealt with no real estate brokers, finders, agents or salesmen other than Cresa, representing both Sublessor and Sublessee, in connection with this transaction. Each party agrees to hold the other party harmless from and against all claims for brokerage commissions, finder's fees or other compensation made by any other agent, broker, salesman or finder as a consequence of such party's actions or dealings with such agent, broker, salesman, or finder. Sublessee shall not be obligated to pay any brokerage commission due to Cresa arising out of this transaction.

21. Notices: Unless at least five (5) days' prior written notice is given in the manner set forth in this paragraph, the address of each party for all purposes connected with this Sublease shall be that address set forth below their signatures at the end of this Sublease. All notices, demands or communications in connection with this Sublease shall be (a) personally delivered; or (b) properly addressed and (i) submitted to an overnight courier service, charges prepaid, or (ii) deposited in the mail (certified, return receipt requested, and postage prepaid). Notices shall be deemed delivered upon receipt, if personally delivered, one (1) business day after being submitted to an overnight courier service and three (3) business days after mailing, if mailed as set forth above. All notices given to Master Lessor under the Master Lease shall be considered received only when delivered in accordance with the Master Lease.

22. Other Sublease Terms:

A. Incorporation By Reference. Except as otherwise provided in or modified by this Sublease, the terms and conditions of this Sublease shall include all of the terms of the Master Lease and such terms are incorporated into this Sublease as if fully set forth herein, except that: (i) each reference in such incorporated sections to "Lease" shall be deemed a reference to "Sublease" and each reference to "Base Monthly Rent" or "Rent" in such incorporated sections (other than Section 13.2 of the Master Lease) shall be deemed a reference to the Base Rent and Rent payable under this Sublease; (ii) each reference to the "Premises" shall be deemed a reference to the "Subleased Premises"; (iii) each reference to "Landlord" and "Tenant" shall be deemed a reference to "Sublessor" and "Sublessee", respectively, except as otherwise expressly set forth herein; (iv) with respect to work, services, repairs, restoration, insurance, indemnities, representations, warranties or the performance of any other obligation of Master Lessor under the Master Lease, the sole obligation of Sublessor shall be to request the same in writing from Master Lessor as and when requested to do so by Sublessee, and to use Sublessor's reasonable efforts (provided Sublessee agrees to pay Sublessor for all reasonable out-of-pocket costs incurred by Sublessor in connection therewith) to obtain Master Lessor's performance as provided in Paragraph 28 of this Sublease; (v) with respect to any obligation of Sublessee to be performed under this Sublease, wherever the Master Lease grants to Sublessor a specified number of days to perform its obligations under the Master Lease, except as otherwise provided herein, Sublessee shall have one (1) fewer day to perform all monetary obligations, and three (3) fewer days to perform non-monetary obligations; provided, however, that with respect to any non-monetary obligations that are required to be performed by Sublessor under the Master Lease in seven (7) days or less, if any, Sublessee shall have two (2) fewer day to perform such obligation, but in no event shall Sublessee shall have less than one (1) day to perform a monetary or non-monetary obligation under this Sublease; (vi) with respect to any approval required to be obtained from the "Landlord" under the Master Lease, such consent must be obtained from both Master Lessor and Sublessor, and the approval of Sublessor may be withheld if Master Lessor's consent is not obtained; (vii) in any case where the "Landlord" reserves or is granted the right to manage, supervise, control, repair, alter, regulate the use of, enter or use the Premises or any areas beneath, above or adjacent thereto, such reservation or grant of right of entry shall be deemed to be for the benefit of both Master Lessor and Sublessor (but Sublessor shall not exercise any such rights as long as Sublessee is not in default of any of its obligations under this Sublease); (viii) in any case where "Tenant" is to indemnify, release or waive claims against "Landlord", such indemnity, release or waiver shall be deemed to run from Sublessee to both Master Lessor and Sublessor, but such indemnification obligations shall only apply to the extent of matters arising during the Term of this Sublease); (ix) in any case where "Tenant" is to execute and deliver certain documents or notices to "Landlord", such obligation shall be deemed to run from Sublessee to both Master Lessor and Sublessor; (x) all payments shall be made to Sublessor, except as otherwise provided in this Sublease or as required by Master Lessor pursuant to its rights under the Master Lease or the Master Lessor Consent (defined below); (xi) with respect to any approval or consent sought by Sublessee under this Sublease, Sublessee shall pay all consent and review fees set forth in the Master Lease to both Master Lessor and Sublessor (it being understood that Sublessor, not Sublessee, shall be obligated to pay any consent or review fees payable to Master Lessor with respect to Master Lessor's consent to this Sublease; (xii) fifty percent (50%) of all "excess rentals" under subleases and assignments, after payment of all such "excess rentals" due to Master Lessor under the Master Lease, shall be paid to Sublessor and (xiii) Sublessor shall not require Sublessee to provide financial statements pursuant to the Sections 7.2 and 13.7 of the Master Lease, as incorporated herein, if Sublessee is listed on a National Exchange.

Notwithstanding the foregoing, (a) the following provisions of the Master Lease shall not be incorporated herein: Article 1 (except for the following definitions: "Tenant's Required Liability Coverage," "Property," "Building," "Outside Areas," "Parking," "Leased Premises," "Tenant's Expense Share," and "Permitted Use,"), Sections 2.1, 2.3, 2.4, 2.5, 3.1, 3.6, 13.3 (first sentence only), 13.10, 14.1 (final clause of last sentence only), 14.2, Article 15, Exhibit B, the First Amendment to Master Lease and the Second Amendment to Master Lease; and (b) references in the following provisions to "Landlord" shall mean Master Lessor only: Sections 3.2, 3.3, 4.4, 4.5 (last two sentences only), 4.6, 4.8, 4.10, 4.11(e), 4.12, 4.13, 5.1, 5.2, 5.4, 6.1 (second and third sentences only), 6.2 (excluding the second sentence), 6.3, 7.2 (4th sentence only), 7.3 (recapture right and joint marketing right only), 9.2, Article 10, Article 11, Sections 12.4 (the entire first sentence and clause (ii) of the second sentence only), 13.5, 13.8, 13.12, 16(b), Exhibit C, and Exhibit D.

B. Performance of Obligations. This Sublease is and at all times shall be subject and subordinate to the Master Lease and the rights of Master Lessor thereunder. Sublessee hereby expressly agrees: (i) to comply with all provisions of the Master Lease with respect to the Term to the extent incorporated hereunder; and (ii) to perform all the obligations on the part of the "Tenant" to be performed under the terms of the Master Lease with respect to the Term of this Sublease which are incorporated hereunder. Sublessee's obligations shall not include (and Sublessor's obligations under this Sublease shall include) the obligations of Sublessor under the Master Lease that Sublessee has not expressly agreed to perform under this Sublease (collectively referred to herein as "Sublessor's Remaining Obligations"). Sublessor shall not agree to amend or modify the Master Lease in any way so as to materially or adversely affect Sublessee or its interest thereunder, increase Sublessee's obligations thereunder or materially restrict Sublessee's rights thereunder, without the prior written approval of Sublessee, which may be withheld in Sublessee's reasonable discretion. Sublessor shall not voluntarily terminate the Master Lease during the term of this Sublease for any reason (including, without limitation, any damage to or destruction of the Subleased Premises caused by a casualty pursuant to Section 10.4 of the Master Lease (except as provided in Paragraph22.C below) or eminent domain action pursuant to Section 11.1 of the Master Lease) without Sublessee's prior written approval unless Master Lessor agrees to continue Sublessee's occupancy of the Subleased Premises for the remainder of the Term on the same terms and conditions of this Sublease. In the event the Master Lease is terminated for any reason whatsoever, this Sublease shall terminate simultaneously with such termination without any liability of Sublessor to Sublessee, unless such termination is occasioned by (i) an Event of Default by Sublessor as the tenant under the Master Lease not arising out of any default or breach of Sublessee hereunder, or (ii) a breach of Sublessor's obligations under this Sublease, including, without limitation, Sublessor's obligations under the preceding sentence of this Paragraph, which termination in either case shall constitute a default by Sublessor hereunder unless Master Lessor agrees to continue Sublessee's occupancy of the Subleased Premises for the remainder of the Term on the same terms and conditions of this Sublease. In the event of a conflict between the provisions of this Sublease and the Master Lease, as between Sublessor and Sublessee, the provisions of this Sublease shall control. In the event of a conflict between the express provisions of this Sublease and the provisions of the Master Lease, as incorporated herein, the express provisions of this Sublease shall prevail.

C. Damage & Destruction. Notwithstanding the foregoing or the terms of the Master Lease, Sublessor and Sublessee agree that, if the Subleased Premises are damaged or destroyed by casualty, (i) Sublessor shall have no obligation whatsoever to repair the damage other than its obligation hereunder to use reasonable efforts to cause Master Lessor to perform its obligations under the Master Lease, (ii) Sublessor will not terminate this Sublease or, unless Sublessee terminates this Sublease as a result of such casualty, the Master Lease as a consequence of such destruction, (iii) Sublessee shall have the right to terminate this Sublease to the extent, but only to the same extent that Sublessor has a right to terminate the Master Lease as a consequence of such destruction and (iv) if Sublessee desires to exercise its right to terminate this Sublease, it shall provide Sublessor with written notice of its exercise of any such election within not less than four (4) days after Sublessee's receipt from Sublessor of a copy of the written opinion of Landlord's architect or construction consultant required under Section 10.4 of the Master Lease regarding the time it will take to complete the restoration work caused by a casualty, and, Sublessee's failure to provide such notice in such four (4) day period shall constitute a waiver of its right to terminate this Sublease in connection with such casualty.

23. Conditions Precedent: This Sublease and Sublessor's and Sublessee's obligations hereunder are conditioned upon each of the following (i) the written consent of Master Lessor in the form attached hereto as Exhibit C the "Master Lessor Consent") or such other form as may be acceptable to Sublessor and Sublessee, (ii) the execution and delivery of the Second Amendment to Master Lease in the form attached hereto as Exhibit D (the "Second Amendment to Master Lease") and (iii) the consent of the Master Landlord's lender to the Second Amendment to Master Lease. If all of the foregoing conditions are not satisfied within thirty (30) days after execution of this Sublease by Sublessor and Sublessee, then Sublessor or Sublessee may terminate this Sublease by giving the other party ten (10) days' prior written notice thereof, in which case this Sublease shall terminate on the day following the last day of the ten (10)-day notice period (unless all such conditions are satisfied during such ten (10)-day period), whereupon Sublessor shall promptly return to Sublessee its payment of the first month's Rent paid by Sublessee pursuant to Paragraph 4 hereof and the Security Deposit. Sublessor shall use reasonable efforts to obtain Master Lessor's execution and delivery of the Master Lessor Consent and the Second Amendment to Master Lease as soon as reasonably practicable.

24. Authority to Execute: Sublessee and Sublessor each represent and warrant to the other that each person executing this Sublease on behalf of each party is duly authorized to execute and deliver this Sublease on behalf of that party.

25. Termination; Recapture: Notwithstanding anything to the contrary herein, Sublessee acknowledges that, under the Master Lease, Master Lessor has certain termination and recapture rights, including, without limitation, in Section 7.3, 10.3, 11.2, and 12.2. Nothing herein shall prohibit Master Lessor from exercising any such rights and Master Lessor shall not have any liability to Sublessee as a result thereof. In the event Master Lessor exercises any such termination or recapture rights, this Sublease shall terminate without any liability to Master Lessor unless such termination is occasioned by an Event of Default by Sublessor as the tenant under the Master Lease not arising out of any default or breach of Sublessee hereunder, which termination shall constitute a default by Sublessor hereunder unless Master Lessor agrees to continue Sublessee's occupancy of the Subleased Premises for the remainder of the Term on the same terms and conditions of this Sublease.

26. Signage; Parking. Subject to Master Lessor's consent and Sublessee's compliance with all applicable provisions of the Master Lease, including Section 4.6, Sublessee, at Sublessee's sole cost and expense, shall have any rights to install signage that are granted to Sublessor under the Master Lease. Sublessee shall have all of Sublessor's parking rights under the Master Lease, at no additional charge to Sublessee, except as provided in Section 4.5 of the Master Lease, as incorporated herein.

27. Quiet Enjoyment; Right to Cure.

A. Sublessee shall peacefully have, hold and enjoy the Subleased Premises, subject to the terms and conditions of this Sublease, provided that Sublessee pays all Rent and performs all of Sublessee's covenants and agreements contained therein. In the event, however, that Sublessor defaults in the performance or observance of any of Sublessor's Remaining Obligations under the Master Lease or fails to perform Sublessor's stated obligations under this Sublease to enforce, for Sublessee's benefit, Master Lessor's obligations under the Master Lease, then Sublessee shall give Sublessor notice specifying in what manner Sublessor has defaulted, and if such default shall not be cured by Sublessor within twenty (20) days thereafter (except that if such default cannot be cured within said twenty (20)-day period, this period shall be extended for an additional reasonable time, provided that Sublessor commences to cure such default within such twenty (20)-day period and proceeds diligently thereafter to effect such cure as soon as reasonably possible), then in addition, Sublessee shall be entitled, at Sublessee's option, to cure such default and promptly collect from Sublessor Sublessee's reasonable out-of-pocket expenses in so doing (including, without limitation, reasonable attorneys' fees and court costs). Sublessee shall not be required, however, to wait the entire cure period described herein if (i) Sublessor's default poses a material and imminent risk to the health or safety of persons, or (ii) earlier action is required to comply with any applicable governmental law, regulation or order. Sublessor shall reimburse Sublessee for the reasonable out of pocket costs incurred by Sublessee in accordance with the terms of this Paragraph 27 (the "Reimbursement Amount") within thirty (30) days after Sublessee's submission to Sublessor of Sublessee's bill therefor, which bill shall be accompanied by receipted, itemized invoices (with reasonable supporting documentation) for the material or services reflected in the bill. In the event Sublessor fails to pay all or any portion of the Reimbursement Amount due Sublessee under this Paragraph 27 within thirty (30) days after receipt of Sublessee's bill therefore, interest shall accrue on such delinquent amount at the Interest Rate until such delinquent amount has been paid or fully offset (as provided hereinbelow), and Sublessee may with ten (10) business days prior notice to Sublessor that it has elected to do so, offset such delinquent amount against the monthly Base Rent due from Sublessee. Notwithstanding the foregoing, if Sublessor delivers to Sublessee a good faith written objection notice within five (5) business days after receipt of Sublessee's notice of intent to offset, setting forth with reasonable particularity Sublessor's reasons for its claim that Sublessor is not required to pay Sublessee all or any specified portion of the Reimbursement Amount, then Sublessee shall not be entitled to offset the disputed portion of the Reimbursement Amount, but Sublessee may institute arbitration proceedings against Sublessor pursuant to Paragraph 27.B below to collect such amount; provided, however, that in the event Sublessee is prevented from instituting an arbitration proceeding because of the existence of the automatic stay under applicable bankruptcy law, Sublessor shall bring a motion to modify the automatic stay to allow Sublessor to arbitrate Sublessee's entitlement to, and the amount of the offset to which Sublessee is entitled, if any, within ten (10) business days after Sublessor's receipt of demand from Sublessee that Sublessor do so, and if Sublessor shall fail to bring such motion within said ten (10) business day period, then notwithstanding the provisions of this sentence to the contrary, Sublessee shall have the right to proceed to offset the disputed amount against monthly Base Rent due from Sublessee as provided in the immediately preceding sentence of this Paragraph 27.

B. All claims or disputes between Sublessor and Sublessee relating to Sublessee's offset rights under Paragraph 27.A shall be resolved by expedited arbitration before one (1) arbitrator. The arbitration shall be administered by JAMS pursuant to its Comprehensive Arbitration Rules and Procedure, modified as follows: (i) the total time from date of demand for arbitration to final award shall not exceed forty-five (45) days; (ii) all notices may be by telephone or other electronic communication with later confirmation in writing; (iii) the time, date, and place of the hearing shall be set by the arbitrator in his or her sole discretion, provided that there shall be at least 10 business days prior notice of the hearing; (iv) there shall be no discovery except by order of the arbitrator; and (v) the arbitrator shall issue his or her award within ten (10) business days after the close of the hearing. The arbitration shall be held in the county in which the Premises are located. The decision of the arbitrator shall be final and binding on the parties and judgment on the award rendered by the arbitrator may be entered in any court of competent jurisdiction. The fees and expenses of the arbitrator shall be paid half by Sublessor and half by Sublessee unless the arbitrator decides otherwise in its decision.

28. Sublessor's Obligation, Sublessee's Rights. To the extent that the provision of any services or the performance of any maintenance or any other act respecting the Subleased Premises or the Building is the responsibility of Master Lessor under the Master Lease (collectively "Master Lessor Obligations"), upon Sublessee's request, Sublessor shall make reasonable efforts to cause Master Lessor to perform such Master Lessor Obligations, and Sublessee shall (i) reimburse Sublessor on demand for any and all reasonable costs and expenses (including reasonable attorneys' fees and costs) incurred by Sublessor in connection therewith, and (ii) indemnify, defend and hold harmless Sublessor from and against any and all losses, costs, liabilities, claims, counterclaims, reasonable out-of-pocket expenses and costs (including reasonable attorneys' fees and costs) arising out of such efforts, except to the extent due to the Sublessor's negligence or willful misconduct. Such reasonable efforts shall include, without limitation: (i) upon Sublessee's written request, immediately notifying Master Lessor of its non-performance under the Master Lease, and requesting that Master Lessor perform its obligations under the Master Lease; and (ii) if Sublessor fails to commence appropriate legal action following a default by Master Lessor, permitting Sublessee to commence a lawsuit or other action in Sublessor's name to obtain the performance required from Master Lessor under the Master Lease; provided, however, that if Sublessee commences a lawsuit or other action, Sublessee shall pay all reasonable out-of-pocket costs and expenses incurred in connection therewith, and Sublessee shall indemnify, defend and hold Sublessor harmless from all reasonable costs and expenses incurred by Sublessor in connection therewith, except to the extent due to the Sublessor's negligence or willful misconduct. Except to the extent Sublessor breaches its obligations under this Sublease, in no event shall Sublessor be liable to Sublessee for any liability, loss or damage whatsoever in the event that Master Lessor should fail to perform the Master Lessor Obligations, nor shall Sublessee be entitled to withhold the payment of Rent or terminate this Sublease. It is expressly understood that any indemnities (except as provided in Paragraph 22.A above), warranties, services or repairs to be given or performed by "Landlord" pursuant to the terms of the Master Lease which are incorporated herein by reference are required to be furnished by Master Lessor and not by Sublessor. Sublessor shall not be liable

for any repair or restoration following casualty or destruction required to the Subleased Premises, other than its obligation hereunder to use reasonable efforts to cause Master Lessor to perform its obligations under the Master Lease. Except as otherwise expressly provided in this Sublease, Sublessor shall have no obligations to Sublessee with respect to performance of the Master Lessor Obligations.

29. Sublessor's Representations. Sublessor represents and warrants to Sublessee that: (i) the Master Lease is in full force and effect, and to Sublessor's knowledge there exists under the Master Lease no default or event of default by either Master Lessor or Sublessor, nor, to Sublessor's knowledge, has there occurred any event which, with the giving of notice or the passage of time or both, could constitute such a default or event of default, (ii) the copy of the Master Lease attached hereto is a true, correct and complete copy thereof, (iii) to Sublessor's knowledge, there are no pending or threatened actions, suits or proceedings before any court or administrative agency against Sublessor that could, in the aggregate, materially adversely affect the Subleased Premises or any part thereof, or the ability of Sublessor to perform its obligations under this Sublease or the Master Lease and (iv) to Sublessor's knowledge, Sublessor has not made any alterations to the Subleased Premises (excluding wiring and cabling) that could be required to be removed at the expiration of the term of the Master Lease other than the basketball court installed by Sublessor in the parking area, but only if and to the extent such removal is required by Master Lessor under the Second Amendment to Master Lease). As used herein, the phrase "to Sublessor's knowledge" shall be deemed to refer to facts within the actual knowledge only of John Ewert, Sublessor's Vice President, Finance, as of the date of this Sublease, and no others, without duty of inquiry whatsoever.

30. Furniture, Fixtures and Equipment: Sublessee shall have the right to use during the Term the office furnishings within the Subleased Premises which are identified on Exhibit B attached hereto (the "Furniture") at no additional cost to Sublessee. The Furniture is provided in its "AS IS, WHERE IS" condition, without representation or warranty whatsoever, except that Sublessor represents and warrants to Sublessee that Sublessor holds legal title to the Furniture free of all liens and other encumbrances and has the right to convey legal title to the Furniture to Sublessee. Sublessee shall insure the Furniture under the property insurance policy required under the Master Lease, as incorporated herein. Sublessee shall maintain the Furniture in good condition and repair, reasonable wear and tear excepted, and shall be responsible for any loss or damage to the same occurring during the Term. Sublessee shall surrender the Furniture to Sublessor upon the termination of this Sublease in the same condition as exists as of the Commencement Date, reasonable wear and tear excepted. Sublessee shall not remove any of the Furniture from the Subleased Premises. Notwithstanding the foregoing, provided Sublessee is not then in default under this Sublease beyond applicable notice and cure periods and (ii) this Sublease has not terminated prior to the Expiration Date due to a default by Sublessee, which conditions may be waived by Sublessor in its sole discretion, then upon the termination of this Sublease, Sublessee shall have the option to purchase the Furniture from Sublessor for a price of One Dollar ($1.00), and, if Sublessee properly exercises such option, Sublessor shall provide a bill of sale in a commercially reasonable form for such Furniture promptly upon request by Sublessee.

[*Signatures on following page*]

IN WITNESS WHEREOF, the parties have executed this Sublease as of the day and year first above written.

SUBLESSEE:	**SUBLESSOR:**
GIGAMON INC. a Delaware corporation	PALO ALTO NETWORKS, INC. a Delaware corporation
By: /s/ Paul Hooper	By: /s/ Jeffrey C. True
Name: Paul Hooper	Name: Jeffrey C. True
Its: Chief Executive Officer	Its: VP & General Counsel
Address:	Address:
Prior to the Commencement Date: GIGAMON INC. 598 Gibraltar Drive Milpitas, CA 95035 Attn: General Counsel	Prior to the Commencement Date: PALO ALTO NETWORKS, INC. 3300 Olcott Street Santa Clara, CA 95054 Attn: General Counsel
After the Commencement Date: GIGAMON INC. 3300 Olcott Street Santa Clara, CA 95054 Attn: General Counsel	After the Commencement Date: PALO ALTO NETWORKS, INC. 4401 Great America Parkway Santa Clara, CA 95054 Attn: General Counsel

EXHIBIT A

MASTER LEASE

[See attached]

EXHIBIT B

FURNITURE, FIXTURES AND EQUIPMENT

OLCOTT FURNITURE INVENTORY

6/7/2013

ITEM	1st Flr. QTY.	2nd Flr. QTY.	TOTAL
Workstations	250	273	523
Office furniture	8	6	14
CHAIRS			
Conference Rm. Chair	80	198	278
EBC Conference Rm. Chair	42	0	42
Guest Chair	16	19	35
Lobby/Lounge Chair	20	8	28
Training Rm. Chair	30	0	30
Tall Café Chair	12	0	12
Lunch Room Chair	0	100	100
TABLES			
Conference Rm. Table	7	13	20
EBC Conference Rm. Table	2	0	2
Coffee/Lounge Table	6	3	9
Training Table	16	0	16
Lunch Room Table	0	23	23
Café Table	5	0	5
FILE CABINETS			
4-Drawer File Cabinet	12	1	13
Vertical File Cabinet	4	0	4
MISCELLANEOUS			
Freestanding White Boards	18	7	25
Metro Shelf	1	0	1
Bookshelf in open area	2	1	3
Podium	1	0	1
Freestanding Desk	4	1	5
2 post racks (all)			
AV Equipment			
Ceiling mounted AV Equipment (all)			

EXHIBIT C

FORM OF MASTER LESSOR CONSENT

[See attached]

EXHIBIT D

SECOND AMENDMENT TO MASTER LEASE

[See attached]

<u>EXHIBIT E</u>

DESCRIPTION OF SUBLESSOR'S INTENDED IMPROVEMENTS

Engineering Lab #250: Design tenant improvements to Gigamon, Inc. Specifications

- Rearrange existing ladder and equipment racks.
- Install additional ladder and equipment racks
- Structural reinforcement of Lab #250 if / as required following structural engineering evaluation
- Rearrange existing HVAC distribution to accommodate equipment layout
- Install supplemental HVAC units (+/- 50 tons of cooling via roof mount or CRAC units), Electrical and Network capacity and distribution wire management

Site: Installation of EV (electric vehicle) charging station

EXHIBIT B

CONSENT TO SUBLEASE

THIS AGREEMENT ("Agreement") is made as of this 2nd day of July, 2013, by and among SANTA CLARA OFFICE PARTNERS LLC, a Delaware limited liability company ("Landlord"), PALO ALTO NETWORKS, INC., a Delaware corporation ("Sublandlord"), and GIGAMON INC., a Delaware corporation ("Subtenant").

RECITALS

A. Landlord is the landlord and Sublandlord is the tenant under that certain Lease dated as of October 20, 2010, as amended by that certain Amendment No. 1 to Lease dated as of March __, 2011 [original undated] and executed by Landlord on April 12, 2011, as further amended by that certain Amendment No. 2 to Lease (the "Second Amendment to Master Lease") dated as of the date of this Consent to Sublease (collectively, the "Master Lease"), for approximately 105,664 square feet of space (the "Leased Premises"), comprising all of the rentable square footage of the office building whose address is 3300 Olcott Street in Santa Clara, California (the "Building").

B. Capitalized terms used but not defined in this Agreement shall have the meanings assigned to them in the Master Lease.

C. Sublandlord has requested that Landlord consent to the subletting by Sublandlord to Subtenant of 100% of the Leased Premises ("Sublet Premises"), pursuant to the Sublease dated the same date as this Agreement (the "Sublease"), and to which Sublease this Agreement is attached.

AGREEMENT

NOW, THEREFORE, in consideration of the foregoing recitals and the mutual covenants contained herein, Landlord, Sublandlord and Subtenant hereby agree as follows:

Landlord hereby consents to the Sublease subject to and upon the following terms and conditions, as to each of which Sublandlord and Subtenant expressly agree:

1. Notwithstanding any provision of the Sublease to the contrary, nothing contained in this Agreement or the Sublease shall:

(a) operate as a consent to or approval or ratification by Landlord of any specific provisions of the Sublease or as a representation or warranty by Landlord, or cause Landlord to be estopped or bound in any way by any of the provisions of the Sublease; or

(b) be construed to modify, waive or affect (i) any of the provisions, covenants or conditions in the Master Lease, (ii) any of Sublandlord's obligations under the Master Lease, or (iii) any rights or remedies of Landlord under the Master Lease or otherwise; or to enlarge or increase Landlord's obligations or Sublandlord's rights under the Master Lease or otherwise; or

(c) be deemed to make Subtenant a third party beneficiary of the provisions of the Master Lease, or create or permit any direct right of action by Subtenant against Landlord for breach of the covenant of quiet enjoyment or any other covenant of Landlord under the Master Lease; or

(d) be construed to waive any past, present or future breach or default on the part of Sublandlord under the Master Lease.

2. This consent is not assignable.

3. The Sublease shall be subject and subordinate at all times to the Master Lease and to all of its provisions, covenants and conditions. Except for rent payable under the Master Lease, Sublandlord's obligations to remove or restore the Alterations which were the subject of the Alteration Approval Letters (as defined in the Second Amendment to Master Lease), and Sublandlord's obligations with respect to any Hazardous Materials first introduced to the Leased Premises or Property prior to the delivery of possession of the Sublet Premises to Subtenant under the Sublease (none of which is Subtenant obligated to perform), Subtenant shall perform faithfully and be bound by all the terms, covenants, conditions, provisions and agreements of the Master Lease, with respect to the period covered by the Sublease, but only to the extent applicable to the Sublet Premises. In the event that Subtenant exercises the option set forth in Section 19 below and becomes a direct tenant of Landlord's pursuant to the Option Term Lease, or in the event Landlord, in its sole and absolute discretion, agrees to enter into the Alternative Direct Lease (as defined in the Second Amendment to Master Lease), Subtenant, with Sublandlord's consent, may at that time elect to have certain of the remaining removal and restoration and surrender obligations set forth in Paragraph 2.6 of the Master Lease be deferred to the expiration or earlier termination of the Option Term Lease or the Alternative Direct Lease, as applicable, such election (a) to be made by written notice signed by both Sublandlord and Subtenant and delivered to Landlord simultaneously with Subtenant's execution and delivery of the Option Term Lease, (b) to include the removal and restoration and surrender obligations being deferred and Subtenant's assumption of such obligations, and (c) be in form satisfactory to Landlord in Landlord's reasonable discretion. In case of any conflict between the provisions of the Master Lease and the provisions of the Sublease, the provisions of the Master Lease shall prevail unaffected by the Sublease; provided, however, that as between Sublandlord and Subtenant only, the provisions of the Sublease shall govern and control. Subtenant acknowledges and agrees that Landlord shall have no obligation to enter into the Alternative Direct Lease, and may refuse to do so for any reason or no reason.

4. Neither the Sublease nor this consent thereto shall release or discharge the Sublandlord from any liability under the Master Lease. Sublandlord shall remain liable and responsible for the full performance and observance of all the provisions, covenants and conditions set forth in the Master Lease to be performed and observed by Sublandlord. Any breach or violation of any provision of the Master Lease by Subtenant shall constitute a default by Sublandlord in fulfilling such provision.

5. This consent by Landlord shall not be construed as a consent by Landlord to any further subletting as defined in the Master Lease (a "subletting") by Sublandlord or Subtenant or to any assignment as defined in the Master Lease (an "assignment") by Sublandlord of the Master Lease or assignment by Subtenant of the Sublease, whether or not the Sublease purports to permit the same, and, without limiting the generality of the foregoing, both Sublandlord and Subtenant agree that Subtenant has no right whatsoever to assign, mortgage or encumber the Sublease nor to sublet any portion of the Sublet Premises or permit any portion of the Sublet Premises to be used or occupied by any other party: (a) without the prior written consent of Sublandlord, as and to the extent Sublandlord's consent would be required under the Sublease, and (b) without the prior written consent of Landlord, as and to the extent Landlord's consent would be required under the Master Lease. This consent shall not be construed as a consent by Landlord to any modification, amendment, extension or renewal of the Sublease. Sublandlord and Subtenant acknowledge and agree that except for any exercise of Subtenant's rights under Section 19 of this Agreement, the attempted exercise of any option to extend the term of the Sublease or to expand the Sublet Premises by the Subtenant shall, for purposes of the Master Lease and this Agreement, constitute a further subletting subject to the provisions of this Article 5.

6. In the event of Sublandlord's default under any of the provisions of the Master Lease beyond applicable notice and cure periods expressly set forth in the Master Lease, the rent due from Subtenant under the Sublease shall be deemed assigned to Landlord and Landlord shall have the right, upon such default, at any time at its option, to give notice to Subtenant of such assignment. Landlord shall credit Sublandlord with any rent received by Landlord under such assignment and Sublandlord acknowledges its approval of any such assignment and payment of rent by Subtenant to Landlord (and Sublandlord shall credit Subtenant under the Sublease with any rent paid by Subtenant to Landlord under such assignment), but the acceptance of any payment on account of rent from Subtenant as the result of any such default shall in no manner whatsoever serve to release Sublandlord from any liability under the terms, covenants, conditions, provisions or agreements under the Master Lease, except to the extent of the rent so credited.

7. If the Master Lease shall expire or terminate during the term of the Sublease due either to condemnation or to destruction by fire or other cause, the Sublease and its term shall thereupon expire and come to an end and Subtenant shall vacate the Sublet Premises on or before the effective date of such termination. If the Master Lease shall expire or terminate during the term of the Sublease for any reason other than either condemnation or destruction by fire or other cause, Landlord will so notify Sublandlord and Subtenant in writing and within not more than thirty (30) days after the giving of such written notice, Landlord will, in its sole discretion, either: (a) elect by written notice to all such parties to require Subtenant to vacate the Sublet Premises in not less than seventy-five (75) days after such written election, in which event the Sublease and its term shall expire and come to an end on the effective date stated in such notice; or (b) elect (by written notice to all such parties) to continue the Sublease (without any additional or further agreement of any kind on the part of Subtenant) with the same force and effect as if Landlord as landlord and Subtenant as tenant had entered into a lease as of the effective date of such expiration, termination or surrender for a term equal to the then unexpired term of the Sublease and containing the same terms and conditions as those contained in the Sublease, in which event Subtenant shall attorn to Landlord and Landlord and Subtenant shall have the same rights, obligations and remedies thereunder as were had by Sublandlord and Subtenant thereunder prior to such effective date, except that in no event shall Landlord be (1) liable for any act or omission by Sublandlord, (2) subject to any offsets or defenses which Subtenant had or might have against Sublandlord that has not been received by Landlord, (3) bound by any rent or additional rent or other payment paid by Subtenant to Sublandlord in advance that has not been paid to Landlord by Sublandlord, or (4) bound by any amendment to the Sublease not consented to by Landlord. If Landlord fails to notify Sublandlord and Subtenant of its election hereunder within the thirty (30) day period provided above, the Sublease and its term shall automatically expire and come to an end on the date which is seventy-five (75) days after the end of such thirty (30) day period. Upon expiration of the Sublease pursuant to the provisions of this Article 7, in the event of the failure of Subtenant to vacate the Sublet Premises as herein provided, Landlord shall be entitled to all of the rights and remedies available to a landlord against a tenant holding over without consent after the expiration of a term.

8. In addition to complying with Sublandlord’s obligations under the Master Lease to maintain insurance, Subtenant shall add and maintain Landlord as an additional insured under Subtenant’s commercial general liability insurance policies. Notwithstanding anything to the contrary in Master Lease, Sublease or this Agreement, Landlord hereby releases Subtenant and its respective partners, principals, shareholders, members, officers, agents, employees and servants, and Subtenant hereby releases Landlord and its respective partners, principals, shareholders, members, officers, agents, employees and servants, from any and all liability for loss, damage or injury to the property of the other in or about the Sublet Premises or the Property which is caused by or results from any risk insured against under any property insurance policy actually carried or required to be carried by any such parties under this Sublease or the Master Lease. Each party shall cause each insurance policy obtained by it to provide that the insurer waives all right of recovery against the other party and its agents and employees in connection with any damage or injury covered by the policy.

9. Both Sublandlord and Subtenant shall be and continue to be liable for the payment of (a) all bills rendered by Landlord for charges incurred by or imposed upon Subtenant for services and materials supplied to the Sublet Premises beyond that which is required by the terms of the Master Lease, and (b) any additional costs incurred by Landlord in accordance with its rights under or pursuant to the Master Lease and this Agreement for maintenance and repair of the Sublet Premises as the result of Subtenant occupying the Sublet Premises (including, but not limited to, any excess costs to Landlord of services furnished to or for the Sublet Premises).

10. Notwithstanding anything to the contrary contained in the Sublease, all requests for any service to be supplied by Landlord to the Sublet Premises, all requests to make improvements or alterations to the Sublet Premises, all requests to further sublet the Sublet Premises or assign the Sublease and all other requests for Landlord’s consent or approval must be made by Sublandlord on behalf of Subtenant.

11. Subtenant represents, warrants and agrees that it has not had any dealings with any real estate broker(s), leasing agent(s), finder(s) or salesmen, other than the Cresa with respect to the Sublease, and that it will indemnify, defend with competent counsel approved by Landlord, and hold Landlord harmless from any liability for the payment of any real estate brokerage commissions, leasing commissions or finder’s fees claimed by any other real estate broker(s), leasing agent(s), finder(s), or salesmen to be earned or due and payable by reason of Subtenant’s agreement or promise (implied or otherwise) to pay (or to have Landlord pay) such a commission or finder's fee by reason of the Sublease. In reliance on the foregoing, Landlord shall pay a leasing commission to Cresa on account of this Sublease and the Second Amendment to Master Lease in the aggregate amount of $919,325 pursuant to, in accordance with, and subject to the conditions contained in, a separate written agreement signed by Landlord and Cresa.

12. Sublandlord and Subtenant understand and acknowledge that Landlord's consent herein is not a consent to any improvement or alteration work to be performed in the Sublet Premises (including without limitation any improvement work contemplated in the Sublease), that Landlord's consent for such work must be separately sought, and that any such work shall be subject to all the provisions of the Master Lease with respect thereto.

13. In the event of any conflict between the provisions of this Agreement and the provisions of the Sublease, the provisions of this Agreement shall prevail unaffected by the Sublease; provided, however, that as between Sublandlord and Subtenant only, the provisions of the Sublease shall govern and control.

14. Any notice or communication that any party hereto may desire or be required to give to any other party under or with respect to this Agreement shall be given prepaid, by hand delivery, Federal Express, or other nationally recognized overnight courier service, addressed to such other party, in the case of Landlord and Sublandlord, at the address set forth in the Master Lease, and in the case of Subtenant, at the Sublet Premises, or in any case at such other address any party may have designated by notice given in accordance with the provisions of this paragraph.

15. Sublandlord and Subtenant agree, at any time and from time to time, upon not less than fifteen (15) days' prior notice by Landlord, to execute, acknowledge and deliver to Landlord a statement in writing certifying that the Sublease is unmodified and in full force and effect (or, if there have been modifications, that the Sublease is in full force and effect as modified and stating the modification), and the dates to which the annual base rental, additional rent and other charges have been paid, and stating whether or not Sublandlord or Subtenant is in default in performance of any covenant, agreement, term, provision or condition contained in the Sublease and, if so, specifying each such default, it being intended that any such statement delivered pursuant hereto may be relied upon by Landlord and any prospective purchaser or lessee of the Building, or any trustee or beneficiary under any deed of trust affecting the Building. Sublandlord and Subtenant also agree to execute and deliver from time to time such other estoppel certificates as Landlord or any lender may require with respect to the Lease or the Sublease.

16. In the event of any arbitration or action or proceeding at law or in equity between or among the parties to this Agreement as a consequence of any controversy, claim or dispute relating to this Agreement or the breach thereof, or to enforce any of the provisions and/or rights hereunder, the unsuccessful party or parties to such arbitration, action or proceeding shall pay to the prevailing party or parties all costs and expenses, including reasonable attorney's fees incurred therein by such prevailing party or parties, and if such prevailing party or parties shall recover judgment in any such arbitration, action or proceeding, such costs, expenses and fees shall be included in and as part of such judgment.

17. Each of Subtenant and Sublandlord agrees, jointly and severally, that it shall indemnify, defend and hold Landlord harmless from and against any and all claims arising out of (a) Subtenant's use of the Sublet Premises or any part thereof for the conduct of its business, or (b) any activity, work or other thing done, permitted or suffered by Subtenant in or about the Building or the Sublet Premises, or any part thereof, or (c) any breach or default in the performance of any obligation on Subtenant's part to be performed under the terms of the Sublease or this Agreement, or (d) any act, omission, or negligence of Subtenant or any officer, agent, employee, contractor, servant, invitee or guest of Subtenant; and in each case from and against any and all damages, losses, liabilities, lawsuits, judgments, and costs and expenses (including without limitation reasonable attorneys' fees) arising in connection with any such claim or claims as described in clauses (a) through (d) above, or any action or proceeding brought thereon. The foregoing indemnification shall not apply to losses or damages to the extent proximately caused by the negligence or willful misconduct of Landlord or any of Landlord's agents, employees or contractors acting on Landlord's behalf. If any such action or proceeding be brought against Landlord, the indemnifying party, upon notice from Landlord, shall defend such action or proceeding at the indemnifying party's sole expense by counsel reasonably satisfactory to Landlord. Subtenant, as a material part of the consideration to Landlord, hereby assumes all risk of damage or loss to property or injury or death to persons (except to the extent any such injury or death to persons is caused by the gross negligence or willful misconduct of Landlord or any of Landlord's authorized representatives), in, upon or about the Sublet Premises, from any cause, and Subtenant hereby waives all claims in respect thereof against Landlord (except for claims arising from any injury or death to persons to the extent caused by the gross negligence or willful misconduct of Landlord or any of Landlord's authorized representatives). Landlord and Sublandlord hereby agree that neither the foregoing nor any other provisions of this Agreement shall be interpreted to narrow the scope of any indemnification, defense, or hold harmless obligations of Sublandlord under the Master Lease.

18. Notwithstanding anything to the contrary in the Master Lease or this Agreement, Landlord hereby agrees that (i) none of the following shall constitute a Transfer of the Sublease or the Master Lease: any change in the controlling ownership interest of the entity that constitutes Subtenant which results from any of the following: (a) the infusion of additional equity capital in Subtenant or an initial public offering of equity securities of Subtenant under the Securities Act of 1933, as amended, which results in Subtenant's stock being traded on a national securities exchange, including, but not limited to, the NYSE, the NASDAQ Stock Market or the NASDAQ Small Cap Market System (a "National Exchange"); or (b) any transfer or sale of the stock or other ownership interest in Subtenant (1) to the spouse(s) and/or children of a shareholder of Subtenant, (2) to any trust, the beneficiary(ies) of which are family members of a shareholder of Subtenant, (3) by reason of bequest or inheritance, or (4) in connection with the issuance of warrants or stock options to purchase Subtenant's stock, and the exercise of any purchase rights under any such warrants or stock options; provided, that any such issuance or exercise does not result in a change in the controlling percentage (as defined in the Master Lease) of the stock or other equity interests of Subtenant; and (ii) Subtenant may assign the Sublease or sublet the Sublet Premises, without any "recapture right" by Landlord and without any obligation to pay to Landlord "assignment consideration" or "excess rentals" (as such terms are defined in the Master Lease) to any entity (i) controlling, controlled by or having fifty percent (50%) or more common control with Subtenant, or (ii) resulting from a merger, non-bankruptcy reorganization or consolidation with Subtenant or acquisition of substantially all of the assets and/or substantially all of the stock of Subtenant (each, a "Permitted Transferee"); provided that (w) any such entity shall assume the obligations and liabilities of Subtenant under the Sublease (or such of such obligations and liabilities as are to be performed by the Subtenant under the terms of the applicable sublease in the event of a sublease), and no such assignment or sublease shall in any manner release Subtenant from its primary liability under the Sublease, (x) any such entity has a net worth at the time of such assignment or sublease that is sufficient to undertake the financial obligations under the Sublease and at least equal to that of Subtenant immediately before the merger, acquisition or other transaction, (y) Subtenant provides Landlord with at least ten (10) days prior written notice of such transaction (or within ten (10) days after such transaction if Subtenant is prevented by law or any bona fide confidentiality agreement from providing prior notice to Landlord) together with such information reasonably required by Landlord that establishes that the underlying transaction complies with the provisions of this sentence and (z) Subtenant is not in monetary or material non-monetary default under the Sublease beyond applicable notice and cure periods at the time of the proposed Transfer.

19. So long as Gigamon Inc. or a Permitted Transferee is then the Subtenant and occupies not less than seventy-five percent (75%) of the Sublet Premises, Landlord hereby grants Subtenant one (1) option to lease the entirety of the Sublet Premises for a period of five (5) years commencing from the expiration of the initial term of the Master Lease (the "Option Term"), subject to the following conditions:

(a) The option to lease shall be exercised, if at all, by notice of exercise given to Landlord by Subtenant not more than eighteen (18) months nor less than twelve (12) months prior to the expiration of the term of the Master Lease.

(b) Anything herein to the contrary notwithstanding, if an Event of Default exists under the Sublease or the Master Lease at the time Subtenant exercises the extension option, Landlord shall have, in addition to all of Landlord's other rights and remedies provided in the Master Lease, the right to terminate such option to lease upon notice to Subtenant. The foregoing shall not be deemed to prohibit Subtenant from curing any Event of Default prior to exercising such option.

(c) In the event the option is exercised in a timely fashion, Tenant shall lease the Sublet Premises from Landlord for the Option Term upon all of the terms and conditions of the Master Lease, but (i) as modified by Section 3 of this Agreement, (ii) deleting Article 15 thereof, and (iii) deleting any obligations of Landlord under the Lease (including the Work Letter) or otherwise to pay any allowances or perform any work other than as required by

Paragraph 5.1(b) of the Master Lease (the "Option Term Lease"), provided that the Base Monthly Rent for the Option Term shall be the "Fair Market Rent" for the Sublet Premises, increased as set forth below. For purposes hereof, "Fair Market Rent" shall mean the Base Monthly Rent determined pursuant to the process described below. At the end of the first 12 month period of the Option Term, Base Monthly Rent shall be increased to reflect the change in the Consumer Price Index for the San Francisco Metropolitan Area, All Items (the "CPI"), for the 12-month period ending 11 months after the commencement date of the Option Term, but in no event shall Base Monthly Rent be increased less than 3% per annum compounded annually nor more than 6% per annum compounded annually for such 12 month period. Base Monthly Rent shall be so adjusted at the end of each subsequent 12-month period during the Option Term. No leasing commissions shall be due or payable to any broker retained by Subtenant with regard to such Option Term Lease.

(d) Subtenant's Election. Within thirty (30) days after receipt of Subtenant's notice of exercise, Landlord shall notify Subtenant in writing of Landlord's estimate of the Base Monthly Rent for the Option Term, based on the provisions of Paragraph (c) above. Within thirty (30) days after receipt of such notice from Landlord, Subtenant shall have the right either to (i) accept Landlord's statement of Base Monthly Rent as the Base Monthly Rent for the Option Term; or (ii) elect to arbitrate Landlord's estimate of Fair Market Rent, such arbitration to be conducted pursuant to the provisions hereof. Failure on the part of Subtenant to require arbitration of Fair Market Rent within such 30-day period shall constitute acceptance of the Base Monthly Rent for the Option Term as calculated by Landlord. If Subtenant elects arbitration, the arbitration shall be concluded within 90 days after the date of Subtenant's election, subject to extension for an additional 30-day period if a third arbitrator is required and does not act in a timely manner. To the extent that arbitration has not been completed prior to the expiration of any preceding period for which Base Monthly Rent has been determined, Subtenant shall pay Base Monthly Rent under the Option Term Lease at the rate due for the last month of the term of the Sublease, with the potential for an adjustment to be made once Fair Market Rent is ultimately determined by arbitration.

(e) Rent Arbitration. In the event of arbitration, the judgment or the award rendered in any such arbitration may be entered in any court having jurisdiction and shall be final and binding between the parties. The arbitration shall be conducted and determined in the City and County of San Francisco in accordance with the then prevailing rules of the American Arbitration Association or its successor for arbitration of commercial disputes except to the extent that the procedures mandated by such rules shall be modified as follows:

i. Subtenant shall make demand for arbitration in writing within thirty (30) days after service of Landlord's determination of Fair Market Rent given under Paragraph (d) above, specifying therein the name and address of the person to act as the arbitrator on its behalf. The arbitrator shall be a real estate broker with at least ten (10) years of experience in the City of Santa Clara market area, or a qualified as a real estate appraiser familiar with the Fair Market Rent of similar industrial, research and development, or office space in the City of Santa Clara area who would qualify as an expert witness over objection to give opinion testimony addressed to the issue in a court of competent jurisdiction. Failure on the part of Subtenant to make a proper demand in a timely manner for such arbitration shall constitute a waiver of the right thereto. Within fifteen (15) days after the service of the demand for arbitration, Landlord shall give notice to Subtenant, specifying the name and address of the person designated by Landlord to act as arbitrator on its behalf who shall be similarly qualified. If Landlord fails to notify Subtenant of the appointment of its arbitrator, within or by the time above specified, then the arbitrator appointed by Subtenant shall be the arbitrator to determine the issue.

ii. In the event that two arbitrators are chosen pursuant to Paragraph (e)(i) above, the arbitrators so chosen shall, within fifteen (15) days after the second arbitrator is appointed determine the Fair Market Rent. If the two arbitrators shall be unable to agree upon a determination of Fair Market Rent within such 15-day period, they, themselves, shall appoint a third arbitrator, who shall be a competent and impartial person with qualifications similar to those required of the first two arbitrators pursuant to Paragraph (e)(i). In the event they are unable to agree upon such appointment within seven days after expiration of such 15-day period, the third arbitrator shall be selected by the parties themselves, if they can agree thereon, within a further period of fifteen (15) days. If the parties do not so agree, then either party, on behalf of both, may request appointment of such a qualified person by the then Presiding Judge of the California Superior Court having jurisdiction over the County of Santa Clara, acting in his or her private and not in his or her official capacity, and the other party shall not raise any question as to such Judge's full power and jurisdiction to entertain the application for and make the appointment. The three arbitrators shall decide the dispute if it has not previously been resolved by following the procedure set forth below.

iii. Where an issue cannot be resolved by agreement between the two arbitrators selected by Landlord and Subtenant or settlement between the parties during the course of arbitration, the issue shall be resolved by the three arbitrators within 15 days of the appointment of the third arbitrator in accordance with the following procedure. The arbitrator selected by each of the parties shall state in writing his determination of the Fair Market Rent supported by the reasons therefor with counterpart copies to each party. The arbitrators shall arrange for a simultaneous exchange of such proposed resolutions. The role of the third arbitrator shall be to select which of the two proposed resolutions most closely approximates his determination of Fair Market Rent. The third arbitrator shall have no right to propose a middle ground or any modification of either of the two proposed resolutions. The resolution he chooses as most closely approximating his determination shall constitute the decision of the arbitrators and be final and binding upon the parties.

iv. In the event of a failure, refusal or inability of any arbitrator to act, his successor shall be appointed by him, but in the case of the third arbitrator, his successor shall be appointed in the same manner as provided for appointment of the third arbitrator. The arbitrators shall decide the issue within fifteen (15) days after the appointment of the third arbitrator. Any decision in which the arbitrator appointed by Landlord and the arbitrator appointed by Subtenant concur shall be binding and conclusive upon the parties. Each party shall pay the fee and expenses of its respective arbitrator and both shall share the fee and expenses of the third arbitrator, if any, and the attorneys' fees and expenses of counsel for the respective parties and of witnesses shall be paid by the respective party engaging such counsel or calling such witnesses.

v. The arbitrators shall have the right to consult experts and competent authorities to obtain factual information or evidence pertaining to a determination of Fair Market Rent, but any such consultation shall be made in the presence of both parties with full right on their part to cross examine. The arbitrators shall render their decision and award in writing with counterpart copies to each party. The arbitrators shall have no power to modify the provisions of the Option Term Lease.

20. Tenant and Subtenant have asked Landlord to specifically acknowledge, and Landlord hereby acknowledges, that (a) Subtenant shall have all of Tenant's rights under the Master Lease regarding signage and parking which have been granted by Tenant to Subtenant pursuant to the Sublease, and (b) Landlord will not charge any additional amount to Subtenant regarding signage and parking that is not provided for in the Master Lease.

21. This Agreement shall be construed in accordance with the laws of the State of California and, together with the Sublease and the Master Lease, contains the entire agreement of the parties hereto with respect to the subject matter hereof and may not be changed or terminated orally or by course of conduct.

22. Sublandlord agrees to reimburse to Landlord all reasonable costs and reasonable attorneys' fees incurred by Landlord in conjunction with the processing and documentation of the Sublease.

23. The obligations of the parties to this Agreement shall survive the expiration or termination of the Lease and the Sublease.

24. This Agreement is hereby incorporated into the Sublease and shall be attached to the Sublease.

25. The effectiveness of this Agreement and the parties' obligations hereunder are subject to the receipt by Landlord, no later than ten (10) business days after the date hereof, of the Lender's Consent. Landlord hereby agrees to use diligent efforts to obtain the Lender's Consent by such date; however, if Landlord does not receive the Lender's Consent by such date, this Agreement shall, at any party's option by written notice to the other parties delivered prior to receipt of Lender's Consent (if received after such 10-business-day period), thereupon be deemed terminated and of no further force or effect, and no party shall have any further rights, obligations, or liabilities hereunder. As used herein, the term "Lender's Consent" means a written consent to this Agreement in form reasonably satisfactory to the parties, executed by the holder of the promissory note secured by that certain Construction Deed of Trust, Assignment of Rents and Leases, Security Agreement and Fixture Filing (encumbering the fee interest in the real property of which the Sublet Premises are a part), recorded on April 9, 2008 in the Official Records of Santa Clara, California, at Series No. 19806764, as amended.

IN WITNESS WHEREOF, the parties hereto have duly executed this Agreement as of the day and year first above written.

LANDLORD:

SANTA CLARA OFFICE PARTNERS LLC,
a Delaware limited liability company

By: Menlo Equities III LLC,
a California limited liability company,
its Managing Member

By: Menlo Equities LLC,
a California limited liability company,
its Managing Member

By: Diamant Investments LLC,
a Delaware limited liability company,
its Member

By: /s/ Rick Holmstrom
Rick Holmstrom, Manager

SUBLANDLORD:

PALO ALTO NETWORKS, INC., a Delaware corporation

By: <u>/s/ Jeffrey C. True</u>
Jeffrey C. True, VP & General Counsel

SUBTENANT:

GIGAMON INC., a Delaware corporation

By: <u>/s/ Paul Hooper</u>
Paul Hooper, Chief Executive Officer

EXHIBIT C

ALTERATIONS APPROVAL LETTERS

Exhibit 21.1

LIST OF SUBSIDIARIES
OF
PALO ALTO NETWORKS, INC.

Name of Subsidiary	Jurisdiction of Incorporation
Palo Alto Networks (Australia) Pty Ltd	Australia
Palo Alto Networks (Brasil) Ltda.	Brazil
Palo Alto Networks (Canada) Inc.	Canada
Palo Alto Networks (Germany) GmbH	Germany
Palo Alto Networks (Malaysia), LLC	Delaware
Palo Alto Networks (Mexico) S. de R.L. de C.V.	Mexico
Palo Alto Networks (Netherlands) B.V.	Netherlands
Palo Alto Networks (Norway) AS	Norway
Palo Alto Networks (Singapore) PTE. LTD.	Singapore
Palo Alto Networks (UK) Limited	United Kingdom
Palo Alto Networks Belgium B.V.B.A.	Belgium
Palo Alto Networks FZ LLC	United Arab Emirates
Palo Alto Networks Godo Kaisha	Japan
Palo Alto Networks International, Inc.	Delaware
Palo Alto Networks Korea, Ltd.	South Korea
Palo Alto Networks, L.L.C.	Delaware
PAN C.V.	Netherlands
PAN LLC	Delaware

Exhibit 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statement (Form S-8 No. 333-182762) pertaining to the Palo Alto Networks, Inc. 2005 Equity Incentive Plan, the Palo Alto Networks, Inc. 2012 Equity Incentive Plan and the Palo Alto Networks, Inc. 2012 Employee Stock Purchase Plan of our reports dated September 24, 2013, with respect to the consolidated financial statements of Palo Alto Networks, Inc. and the effectiveness of internal control over financial reporting of Palo Alto Networks, Inc. included in this Annual Report (Form 10-K) for the year ended July 31, 2013.

/s/ Ernst & Young LLP

San Francisco, California
September 24, 2013

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 Annual Report on Form 10-K 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
President, Chief Executive Officer and Director

Date: September 24, 2013

Exhibit 31.2

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

I, Steffan C. Tomlinson, certify that:

1. I have reviewed this Annual Report on Form 10-K 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/ STEFFAN C. TOMLINSON

Steffan C. Tomlinson
Chief Financial Officer

Date: September 24, 2013

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 Annual Report on Form 10-K of Palo Alto Networks, Inc. for the fiscal year ended July 31, 2013, 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 Annual Report on Form 10-K 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
President, Chief Executive Officer and Director

Date: September 24, 2013

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, Steffan C. Tomlinson, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Annual Report on Form 10-K of Palo Alto Networks, Inc. for the fiscal year ended July 31, 2013, 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 Annual Report on Form 10-K fairly presents, in all material respects, the financial condition and results of operations of Palo Alto Networks, Inc.

/s/ STEFFAN C. TOMLINSON
Steffan C. Tomlinson
Chief Financial Officer

Date: September 24, 2013