SPLUNK INC
Form 10-Q
December 06, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(MARK ONE)

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

FOR THE QUARTERLY PERIOD ENDED OCTOBER 31, 2017

OR

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

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER 001-35498

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

Delaware	86-1106510
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

270 Brannan Street
San Francisco, California 94107
(Address of principal executive offices)
(Zip Code)

(415) 848-8400
(Registrant’s telephone number, including area code)

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

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

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
YES o NO ý

There were 141,458,410 shares of the registrant’s Common Stock issued and outstanding as of November 29, 2017.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

Splunk Inc.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share amounts)
(Unaudited)

	October 31, 2017	January 31, 2017
Assets		
Current assets		
Cash and cash equivalents	$393,314	$421,346
Investments, current portion	665,075	662,096
Accounts receivable, net	264,497	238,281
Prepaid expenses and other current assets	44,545	38,650
Total current assets	1,367,431	1,360,373
Investments, non-current	5,000	5,000
Property and equipment, net	161,249	166,395
Intangible assets, net	52,434	37,713
Goodwill	161,382	124,642
Other assets	28,284	24,423
Total assets	$1,775,780	$1,718,546
Liabilities and Stockholders’ Equity		
Current liabilities		
Accounts payable	$12,409	$7,503
Accrued compensation	115,733	100,092
Accrued expenses and other liabilities	74,680	81,071
Deferred revenue, current portion	516,401	478,707
Total current liabilities	719,223	667,373
Deferred revenue, non-current	185,712	146,752
Other liabilities, non-current	99,140	99,260
Total non-current liabilities	284,852	246,012
Total liabilities	1,004,075	913,385
Commitments and contingencies (Note 3)		
Stockholders’ equity		
Common stock: $0.001 par value; 1,000,000,000 shares authorized; 140,983,704 shares issued and outstanding at October 31, 2017, and 137,169,481 shares issued and outstanding at January 31, 2017	141	137
Accumulated other comprehensive loss	(2,074)	(3,013)
Additional paid-in capital	2,028,455	1,828,821
Accumulated deficit	(1,254,817)	(1,020,784)
Total stockholders’ equity	771,705	805,161
Total liabilities and stockholders’ equity	$1,775,780	$1,718,546

The accompanying notes are an integral part of these condensed consolidated financial statements.

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Splunk Inc.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2017	2016	2017	2016
Revenues				
License	$179,829	$139,725	$439,406	$356,412
Maintenance and services	148,824	105,064	411,659	287,082
Total revenues	328,653	244,789	851,065	643,494
Cost of revenues [(1)]				
License	3,013	2,883	9,100	8,713
Maintenance and services	61,154	45,791	173,106	124,077
Total cost of revenues	64,167	48,674	182,206	132,790
Gross profit	264,486	196,115	668,859	510,704
Operating expenses [(1)]				
Research and development	74,080	85,659	217,152	220,254
Sales and marketing	205,364	167,330	570,596	462,709
General and administrative	35,857	34,079	111,492	100,464
Total operating expenses	315,301	287,068	899,240	783,427
Operating loss	(50,815)	(90,953)	(230,381)	(272,723)
Interest and other income (expense), net				
Interest income (expense), net	270	(823)	(422)	(2,023)
Other income (expense), net	(289)	(348)	(1,771)	(2,536)
Total interest and other income (expense), net	(19)	(1,171)	(2,193)	(4,559)
Loss before income taxes	(50,834)	(92,124)	(232,574)	(277,282)
Income tax provision (benefit)	(232)	1,367	1,459	3,702
Net loss	$(50,602)	$(93,491)	$(234,033)	$(280,984)
Basic and diluted net loss per share	$(0.36)	$(0.69)	$(1.68)	$(2.11)
Weighted-average shares used in computing basic and diluted net loss per share	140,413	134,677	139,111	133,273

[(1)] Amounts include stock-based compensation expense, as follows:

Cost of revenues	$7,921	$7,610	$24,523	$22,475
Research and development	25,038	45,355	77,826	102,303
Sales and marketing	36,728	38,750	120,023	118,354
General and administrative	14,424	13,299	44,161	42,115

The accompanying notes are an integral part of these condensed consolidated financial statements.

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Splunk Inc.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(In thousands)
(Unaudited)

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2017	2016	2017	2016
Net loss	$(50,602)	$(93,491)	$(234,033)	$(280,984)
Other comprehensive loss				
Net unrealized gain (loss) on investments	(93)	(336)	(542)	20
Foreign currency translation adjustments	(632)	(900)	1,481	740
Total other comprehensive gain (loss)	(725)	(1,236)	939	760
Comprehensive loss	$(51,327)	$(94,727)	$(233,094)	$(280,224)

The accompanying notes are an integral part of these condensed consolidated financial statements.

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Splunk Inc.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended October 31,	
	2017	2016
Cash flows from operating activities		
Net loss	$(234,033)	$(280,984)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	30,039	22,914
Amortization of investment premiums	373	620
Stock-based compensation	266,533	285,247
Deferred income taxes	(2,677)	(620)
Excess tax benefits from employee stock plans	—	(551)
Facility exit charge - adjustment	(5,191)	—
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable, net	(26,216)	9,176
Prepaid expenses, other current and non-current assets	(8,501)	(8,128)
Accounts payable	4,919	1,530
Accrued compensation	15,626	(12,538)
Accrued expenses and other liabilities	(693)	32,992
Deferred revenue	76,654	49,652
Net cash provided by operating activities	116,833	99,310
Cash flows from investing activities		
Purchases of investments	(517,904)	(523,783)
Maturities of investments	514,010	446,275
Acquisitions, net of cash acquired	(59,350)	—
Purchases of property and equipment	(13,931)	(27,219)
Other investment activities	—	(3,500)
Net cash used in investing activities	(77,175)	(108,227)
Cash flows from financing activities		
Proceeds from the exercise of stock options	2,474	7,355
Excess tax benefits from employee stock plans	—	551
Proceeds from employee stock purchase plan	19,282	15,183
Taxes paid related to net share settlement of equity awards	(88,651)	(73,355)
Repayment of financing lease obligation	(1,299)	—
Net cash used in financing activities	(68,194)	(50,266)
Effect of exchange rate changes on cash and cash equivalents	504	235
Net decrease in cash and cash equivalents	(28,032)	(58,948)
Cash and cash equivalents at beginning of period	421,346	424,541
Cash and cash equivalents at end of period	$393,314	$365,593
Supplemental disclosures		
Cash paid for income taxes	$4,948	$2,421
Cash paid for interest expense related to financing lease obligation	6,068	3,026
Non-cash investing and financing activities		
Increase in accrued purchases of property and equipment	463	1,209
Increase in capitalized construction costs related to build-to-suit lease	—	10,065

The accompanying notes are an integral part of these condensed consolidated financial statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(1) Description of the Business and Significant Accounting Policies

Business

Splunk Inc. (“we,” “us,” “our”) provides innovative software solutions that enable organizations to gain real-time operational intelligence by harnessing the value of their data. Our offerings enable users to collect, index, search, explore, monitor, correlate and analyze data regardless of format or source. Our offerings address large and diverse data sets, commonly referred to as big data, and are specifically tailored for machine data. Machine data is produced by nearly every software application and electronic device and contains a definitive, time-stamped record of various activities, such as transactions, customer and user activities and security threats. Our offerings help users derive new insights from machine data that can be used to, among other things, improve service levels, reduce operational costs, mitigate security risks, demonstrate and maintain compliance, and drive better business decisions. We were incorporated in California in October 2003 and reincorporated in Delaware in May 2006.

Fiscal Year

Our fiscal year ends on January 31. References to fiscal 2018 or fiscal year 2018, for example, refer to the fiscal year ending January 31, 2018.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (“GAAP”) and applicable rules and regulations of the Securities and Exchange Commission (“SEC”) regarding interim financial reporting. Certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. The condensed consolidated balance sheet data as of January 31, 2017 was derived from audited financial statements, but does not include all disclosures required by GAAP. Therefore, these condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Annual Report on Form 10-K for the fiscal year ended January 31, 2017, filed with the SEC on March 29, 2017. There have been no changes in the significant accounting policies from those that were disclosed in the audited consolidated financial statements for the fiscal year ended January 31, 2017 included in the Annual Report on Form 10-K.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all normal recurring adjustments necessary to state fairly the financial position, results of operations, comprehensive loss and cash flows for the interim periods, but are not necessarily indicative of the results of operations to be anticipated for the full fiscal year 2018.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting periods covered by the financial statements and accompanying notes. In particular, we make estimates with respect to the fair value of multiple elements in revenue recognition, uncollectible accounts receivable, the assessment of the useful life and recoverability of long-lived assets (property and equipment, goodwill and identified intangibles), stock-based

compensation expense, the fair value of assets acquired and liabilities assumed for business combinations, income taxes, leases and contingencies. Actual results could differ from those estimates.

Segments

We operate our business as one operating segment: the development and marketing of software solutions that enable our customers to gain real-time operational intelligence by harnessing the value of their data. Our chief operating decision maker is our Chief Executive Officer, who reviews financial information presented on a consolidated basis for purposes of making operating decisions, assessing financial performance and allocating resources.

Principles of Consolidation

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The accompanying unaudited condensed consolidated financial statements include the accounts of Splunk Inc. and its direct and indirect wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated upon consolidation.

Strategic Investments

We hold certain non-marketable equity securities which are accounted for using the cost method of accounting. These investments are recorded at cost in "Investments, non-current" on our condensed consolidated balance sheets and are adjusted only for other-than-temporary impairments and additional investments.

Recently Adopted Accounting Standards

In March 2016, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2016-09 (Topic 718), Compensation - Stock Compensation, which has been issued as part of its Simplification Initiative. The new guidance requires companies to recognize stock-based compensation excess tax benefits, net of detriments (if any) to the condensed consolidated statements of operations, as opposed to additional paid-in capital within equity, when the awards vest or are exercised. Additionally, net excess tax benefit cash flows resulting from share-based payments are required to be reported as operating activities in the statement of cash flows. These updates are to be adopted either prospectively or retrospectively. The new guidance also allows companies to make a policy election to account for forfeitures as they occur, which, if elected, must be adopted using a modified retrospective approach with a cumulative effect adjustment recorded to opening retained earnings.

The ASU is effective for public companies for fiscal years beginning after December 15, 2016 and interim periods within those fiscal years. We adopted this guidance during the first quarter of fiscal year 2018. Excess tax benefits on stock plans have been recorded to the condensed consolidated statements of operations rather than to additional paid-in capital within equity on a prospective basis. At April 30, 2017, we recorded $301.6 million of previously unrecognized excess tax benefits, which are fully offset by the related valuation allowance. We did not record an adjustment to our accumulated deficit as a result of adopting ASC 2016-09. We also elected to prospectively apply the change in presentation requirement wherein income tax effects of awards are classified as operating activities in the condensed consolidated statement of cash flows. Prior period classification of cash flows related to excess tax benefits have not been adjusted. We did not elect an accounting policy change to record forfeitures as they occur and we will continue to estimate forfeitures at each period.

Recently Issued Accounting Pronouncements

In May 2017, the FASB issued ASU No. 2017-09 (Topic 718), Scope of Modification Accounting. The new standard clarifies when changes to the terms or conditions of a share-based payment award must be accounted for as modifications. The standard is effective for our first quarter of fiscal 2019, and although early adoption is permitted, we will not early adopt. We are currently evaluating whether the adoption of this standard will have a material impact on our condensed consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-04 (Topic 350) Intangibles - Goodwill and Other. The new standard simplifies how companies are required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Step 2 measures a goodwill impairment loss by comparing the implied fair value of a reporting unit's goodwill with the carrying amount of that goodwill. Instead, if the carrying amount of a reporting unit exceeds its fair value, an impairment loss shall be recognized in an amount equal to that excess, limited to the total amount of goodwill allocated to that reporting unit. The standard is effective for our first quarter of fiscal 2021, although early adoption is permitted. We do not expect this standard will have a material impact on our condensed consolidated

financial statements upon adoption.

In January 2017, the FASB issued ASU No. 2017-01 (Topic 805) Business Combinations - Clarifying the Definition of a Business. The new standard narrows the application of when an integrated set of assets and activities is considered a business and provides a framework to assist entities in evaluating whether both an input and a substantive process are present to be considered a business. The standard is effective for our first quarter of fiscal 2019, and although early adoption is permitted, we will not early adopt. We anticipate that the adoption of the new guidance will result in more transactions being accounted for as asset acquisitions rather than business combinations and that the new standard will impact management's consideration of strategic investments, but do not expect a material impact on our condensed consolidated financial statements upon adoption.

In October 2016, the FASB issued ASU No. 2016-16 (Topic 740), Intra-Entity Transfers of Assets Other Than Inventory. The new standard will require companies to recognize, as opposed to defer, the tax effects from intercompany transfers of certain assets when the transfer occurs. The standard is effective for our first quarter of fiscal 2019, and although

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early adoption is permitted, we will not early adopt. We are currently evaluating whether the adoption of this standard will have a material impact on our condensed consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13 (Topic 326), Financial Instruments - Credit Losses. The amendments in this update require a financial asset (or a group of financial assets) measured at an amortized cost basis to be presented at the net amount expected to be collected. The new approach to estimating credit losses (referred to as the current expected credit losses model) applies to most financial assets measured at amortized cost and certain other instruments, including trade and other receivables, loans and held-to-maturity debt securities. The standard is effective for our first quarter of fiscal 2021, although early adoption is permitted. We are currently evaluating whether the adoption of this standard will have a material impact on our condensed consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02 (Topic 842), Leases, which supersedes the lease recognition requirements in ASC Topic 840, Leases. The standard requires an entity to recognize right-of-use assets and lease liabilities arising from a lease for operating leases, initially measured at the present value of the lease payments on the condensed consolidated balance sheets. The impact of such leases on the condensed consolidated statements of operations and cash flows will continue to be treated in a similar manner under current GAAP. The standard also requires additional qualitative and quantitative disclosures. The standard is effective for our first quarter of fiscal 2020, although early adoption is permitted. We are currently evaluating the impact of this standard on our condensed consolidated financial statements and related disclosures. We anticipate that most of our office leases will be recognized as lease liabilities and corresponding right-of-use assets, and will accordingly have a material impact on our condensed consolidated balance sheets upon adoption.

In January 2016, the FASB issued ASU No. 2016-01 (Subtopic 825-10), Financial Instruments - Overall. The amendments in this update address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments, and require equity securities to be measured at fair value with changes in fair value recognized through net income. The standard is effective for our first quarter of fiscal 2019, and although early adoption is permitted, we will not early adopt. We do not expect this standard will have a material impact on our condensed consolidated financial statements upon adoption.
In May 2014, the FASB issued ASU No. 2014-09 (Topic 606), Revenue from Contracts with Customers, which supersedes the revenue recognition requirements in Accounting Standards Codification 605, Revenue Recognition and establishes a new revenue standard. This ASU is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU also requires additional disclosure about the nature, amount, timing and uncertainty of revenues and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract.

In March 2016, the FASB issued ASU No. 2016-08, Revenue from Contracts with Customers: Principal versus Agent Considerations, which clarifies the guidance in the new revenue standard on assessing whether an entity is a principal or an agent in a revenue transaction. This conclusion impacts whether an entity reports revenue on a gross or net basis. In April 2016, the FASB issued ASU No. 2016-10, Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing, which clarifies the guidance in the new revenue standard regarding an entity's identification of its performance obligations in a contract. In May 2016, the FASB issued ASU No. 2016-12, Narrow-Scope Improvements and Practical Expedients, which amends the guidance in the new revenue standard on collectability, non-cash consideration, presentation of sales tax, and transition. In December 2016, the FASB issued ASU No. 2016-20, Technical Corrections and Improvements to Topic 606, which clarifies narrow aspects of ASC 606 or corrects unintended application of the guidance.

The new revenue standard, as amended by ASU No. 2015-14, is effective in the first quarter of fiscal 2019 and may be applied retrospectively to each prior period presented or with the cumulative effect recognized as of the date of initial

application. We currently plan to adopt the standard using the cumulative effect transition method and although early adoption is permitted, we will not early adopt.

We are still evaluating the total impact of the new revenue standard on our condensed consolidated financial statements, accounting policies, systems, internal controls, and processes. We have allocated internal and external resources to assist in our implementation and evaluation of the new standard, including implementation of new systems and accounting processes, which will change our internal controls over revenue recognition, sales commission costs and financial reporting. While we cannot reasonably estimate the expected financial statement impact at this time, we believe the adoption of this new standard will have a material impact on our condensed consolidated financial statements, including the way we account for arrangements involving a term license, deferred revenue and sales commissions. Under the new revenue standard, we will be required to recognize term license revenues upfront and the associated maintenance revenues over the contract period. Under

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the current revenue standard, we recognize both the term license and maintenance revenues ratably over the contract period. In addition, some deferred revenue, primarily from arrangements involving term licenses, will never be recognized as revenue upon adoption of the new revenue standard and instead will be part of the cumulative effect adjustment within accumulated deficit. We have also considered the impact of the guidance in ASC 340-40, Other Assets and Deferred Costs; Contracts with Customers, under Topic 606. Under ASC 340-40, we would be required to capitalize and amortize incremental costs of obtaining a contract, such as certain sales commission costs, over the remaining contractual term or over an expected period of benefit, which we have determined to be approximately five years. Under our current accounting policy, we do not capitalize sales commission costs but rather recognize these costs when they are incurred.

(2) Investments and Fair Value Measurements

The carrying amounts of certain of our financial instruments including cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate fair value due to their short-term maturities.

Assets and liabilities recorded at fair value in the financial statements are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Hierarchical levels that are directly related to the amount of subjectivity associated with the inputs to the valuation of these assets or liabilities are as follows:

Level 1—Observable inputs, such as quoted prices in active markets for identical assets or liabilities.

Level 2—Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Assets and liabilities measured at fair value are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires management to make judgments and consider factors specific to the asset or liability.

The following table sets forth the fair value of our financial assets and liabilities that were measured on a recurring basis as of October 31, 2017 and January 31, 2017 (in thousands):

	October 31, 2017				January 31, 2017			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets:								
Money market funds	$293,731	$ —	$ —	$293,731	$345,959	$ —	$ —	$345,959
U.S. treasury securities	—	665,075	—	665,075	—	662,096	—	662,096
Other	—	—	—	—	—	—	3,000	3,000
Reported as:								
Assets:								
Cash and cash equivalents				$293,731				$345,959
Investments, current portion				665,075				662,096
Investments, non-current				—				3,000
Total				$958,806				$1,011,055

Our investments in money market funds are measured at fair value on a recurring basis. These money market funds are actively traded and reported daily through a variety of sources. The fair value of the money market fund investments is classified as Level 1.

The following table represents our investments in U.S. treasury securities, which we have classified as available-for-sale investments as of October 31, 2017 (in thousands):

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	October 31, 2017			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Investments, current portion:				
U.S. treasury securities	$665,848	$ —	$ (773)	$665,075
Total available-for-sale investments in U.S. treasury securities	$665,848	$ —	$ (773)	$665,075

As of October 31, 2017, the following marketable securities were in an unrealized loss position (in thousands):

	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. treasury securities	$665,075	$ (773)	$ —	$ —	$665,075	$ (773)

As of October 31, 2017, we did not consider any of our investments to be other-than-temporarily impaired.

The contractual maturities of our investments are as follows (in thousands):

	October 31, 2017
Due within one year	$665,075
Total	$665,075

Investments with maturities of less than 12 months from the balance sheet date are classified as current assets, which are available for use to fund current operations. Investments with maturities greater than 12 months from the balance sheet date are classified as long-term assets.

Strategic Investments

We hold strategic investments in the form of non-marketable equity securities which are recorded at cost. During the first quarter of fiscal 2018, $3.0 million of our investments in the form of convertible promissory notes in a privately-held company were automatically converted into preferred stock. As a result, these non-marketable equity securities are no longer classified as Level 3 investments measured at fair value and are now accounted for as cost method investments. As of October 31, 2017, our cost method investments totaled $5.0 million.

(3) Commitments and Contingencies

Operating Lease Commitments

We lease our office spaces under non-cancelable leases. Rent expense for our operating leases was $0.3 million for the three months ended October 31, 2017, which includes a decrease of $5.2 million of expense in connection with a facility exit charge adjustment. Refer to “Facility Exit Costs” below for details. Rent expense for our operating leases was $6.0 million for the three months ended October 31, 2016 and $10.8 million and $12.7 million for the nine months ended October 31, 2017 and 2016, respectively.

The following summarizes our operating lease commitments as of October 31, 2017 (in thousands):

	Payments Due by Period				
	Total	Less Than 1 year	1-3 years	3-5 years	More Than 5 years
Operating lease commitments [1]	$164,725	$ 22,503	$41,210	$37,219	$ 63,793

[(1)] We have entered into sublease agreements for portions of our office space and the future rental income of $11.8 million from these agreements has been included as an offset to our future minimum rental payments.

Facility Exit Costs

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In fiscal 2017, we relocated certain of our corporate offices in the San Francisco Bay Area and as a result, a portion of our leased office spaces are no longer in use. Accordingly, we calculated and recorded a liability at the "cease-use" date related to those operating leases based on the difference between the present value of the estimated future sublease rental income and the present value of our remaining lease obligations, adjusted for the effects of any prepaid or deferred items. We recorded a facility exit charge of approximately $8.6 million to "General and administrative" expenses in fiscal 2017 associated with the recognition of the liability. The short-term portion of the liability is recorded in "Accrued expenses and other liabilities" and the long-term portion of the liability is recorded in "Other liabilities, non-current," on the condensed consolidated balance sheets. Cease-use liability balances are presented below (in thousands):

	Carrying amount
Balance as of January 31, 2017	$ 8,625
Facility exit charge - adjustment (revision of estimated sublease income) [1]	(5,191)
Cash payments, net of deferred rent	(2,754)
Balance as of October 31, 2017	$ 680

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[1] During the three months ended October 31, 2017, we entered into sublease agreements for our office spaces that are no longer in use by us. As a result, we made an adjustment to our estimated future sublease rental income related to our cease-use liability.

Financing Lease Obligation

On April 29, 2014, we entered into an office lease (the “Lease”) for approximately 182,000 square feet located at 270 Brannan Street, San Francisco, California (the “Premises”). The Premises is allocated between the "Initial Premises" and "Additional Premises," which are each approximately 91,000 square feet of rentable space. The term of the Additional Premises begins one year after the term of the Initial Premises, which began in August 2015, and each have a term of 84 months. Our total obligation for the base rent is approximately $92.0 million. On May 13, 2014, we entered into an irrevocable, standby letter of credit with Silicon Valley Bank for $6.0 million to serve as a security deposit for the Lease.

As a result of our involvement during the construction period, whereby we had certain indemnification obligations related to the construction, we were considered, for accounting purposes only, the owner of the construction project under build-to-suit lease accounting. We have recorded project construction costs incurred by the landlord as an asset and a corresponding long-term liability in “Property and equipment, net” and “Other liabilities, non-current,” respectively, on our condensed consolidated balance sheets. We moved into the Premises in February 2016. We have determined that the lease does not meet the criteria for “sale-leaseback” treatment, due to our continuing involvement in the construction project resulting from our standby letter of credit. Accordingly, the Lease will continue to be accounted for as a financing obligation.

As of October 31, 2017, future payments on the financing lease obligation are as follows (in thousands):

Fiscal Period:	
Remaining three months of fiscal 2018	$ 3,053
Fiscal 2019	12,552
Fiscal 2020	12,928
Fiscal 2021	13,316
Fiscal 2022	13,715
Fiscal 2023	14,127
Fiscal 2024	8,142
Total future minimum lease payments	$ 77,833

Legal Proceedings

We are subject to certain routine legal and regulatory proceedings, as well as demands and claims that arise in the normal course of our business. We make a provision for a liability relating to legal matters when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impact of negotiations, estimated settlements, legal rulings, advice of legal counsel and other information and events pertaining to a particular matter. In our opinion, resolution of any pending claims (either

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individually or in the aggregate) is not expected to have a material adverse impact on our condensed consolidated results of operations, cash flows or financial position, nor is it possible to provide an estimated amount of any such loss. However, depending on the nature and timing of any such dispute, an unfavorable resolution of a matter could materially affect our future results of operations or cash flows, or both, in a particular quarter.

Indemnification Arrangements

During the ordinary course of business, we may indemnify, hold harmless and agree to reimburse for losses suffered or incurred, our customers, vendors and each of their affiliates for certain intellectual property infringement and other claims by third parties with respect to our offerings, in connection with our commercial license arrangements or related to general business dealings with those parties.

As permitted under Delaware law, we have entered into indemnification agreements with our officers, directors and certain employees, indemnifying them for certain events or occurrences while they serve as our officers or directors or those of our direct and indirect subsidiaries.

To date, there have not been any costs incurred in connection with such indemnification obligations; therefore, there is no accrual of such amounts at October 31, 2017. We are unable to estimate the maximum potential impact of these indemnifications on our future results of operations.

(4) Property and Equipment

Property and equipment are stated at cost, net of accumulated depreciation and amortization. These assets are depreciated and amortized using the straight-line method over their estimated useful lives. Property and equipment consisted of the following (in thousands):

	As of	
	October 31, 2017	January 31, 2017
Computer equipment and software	$68,322	$59,396
Furniture and fixtures	17,194	16,194
Leasehold and building improvements	63,091	58,569
Building [1]	82,250	82,250
	230,857	216,409
Less: accumulated depreciation and amortization	(69,608)	(50,014)
Property and equipment, net	$161,249	$166,395

[1] This relates to the capitalization of construction costs in connection with our financing lease obligation, where we are considered the owner of the asset, for accounting purposes only. There is a corresponding long-term liability for this obligation on our condensed consolidated balance sheets under “Other liabilities, non-current.” Refer to Note 3 “Commitments and Contingencies” for details.

Depreciation and amortization expense on Property and Equipment, net was $6.5 million and $5.3 million for the three months ended October 31, 2017 and 2016, respectively, and $19.5 million and $13.7 million for the nine months ended October 31, 2017 and 2016, respectively.

(5) Acquisitions, Goodwill and Intangible Assets

Rocana

On October 6, 2017, we acquired certain assets of Rocana, Inc. (“Rocana”), a privately-held Delaware corporation that develops analytics solutions for the IT market. This acquisition has been accounted for as a business combination. The purchase price of $30.2 million, paid in cash, was preliminarily allocated as follows: $10.1 million to identifiable intangible assets, with the excess $20.1 million of the purchase price over the fair value of net assets acquired recorded as goodwill. This goodwill is primarily attributable to the value expected from the synergies of the combination, including advancing the analytics and machine learning capabilities of our products, and is deductible for income tax purposes. The results of operations of the acquired entity, which are not material, have been included in our condensed consolidated financial statements from the date of purchase. Pro forma and historical results of operations of the acquired entity have not been presented as we do not consider the

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results to have a material effect on any of the periods presented in our condensed consolidated statements of operations. We are currently finalizing the allocation of the purchase price, which may be subject to change as additional information becomes available to us.

The following table sets forth the components of identifiable intangible assets acquired and their estimated useful lives as of the date of acquisition (in thousands, except useful life):

	Fair Value	Useful Life (months)
Developed technology	$8,320	36
Other acquired intangible assets	1,790	24
Total intangible assets acquired	$10,110	

SignalSense

On September 29, 2017, we acquired 100% of the voting equity interest of SignalSense Inc. (“SignalSense”), a privately held Washington corporation that develops cloud-based data collection and breach detection solutions that leverage machine learning. This acquisition has been accounted for as a business combination. The purchase price of $12.2 million, paid in cash, was preliminarily allocated as follows: $11.3 million to identifiable intangible assets acquired, $0.2 million in net assets and $2.0 million to net deferred tax liabilities, with the excess $2.7 million of the purchase price over the fair value of net assets acquired recorded as goodwill. This goodwill is primarily attributable to the value expected from the synergies of the combination, including developing more advanced cloud and machine learning capabilities for our products, and is not deductible for income tax purposes. The results of operations of the acquired entity, which are not material, have been included in our condensed consolidated financial statements from the date of purchase. Pro forma and historical results of operations of the acquired entity have not been presented as we do not consider the results to have a material effect on any of the periods presented in our condensed consolidated statements of operations. We are currently finalizing the allocation of the purchase price, which may be subject to change as additional information becomes available to us.

The following table sets forth the components of identifiable intangible assets acquired and their estimated useful lives as of the date of acquisition (in thousands, except useful life):

	Fair Value	Useful Life (months)
Developed technology	$11,310	36
Total intangible assets acquired	$11,310	

Other Acquisitions

On May 15, 2017, we acquired 100% of the voting equity interest of a privately-held Delaware corporation that develops technology for search-driven analytics on enterprise data. This acquisition has been accounted for as a business combination. The purchase price of $17.3 million, paid in cash, was preliminarily allocated as follows: $3.8 million to identifiable intangible assets and $0.5 million to net deferred tax liability, with the excess $14.0 million of the purchase price over the fair value of net assets acquired recorded as goodwill. This goodwill is primarily attributable to the value expected from the synergies of the combination, including developing a more intuitive search experience for our products, and is not deductible for income tax purposes. The results of operations of the acquired entity, which are not material, have been included in our condensed consolidated financial statements from the date of purchase. Pro forma and historical results of operations of the acquired entity have not been presented as we do not consider the results to have a material effect on any of the periods presented in our condensed consolidated statements of operations. We are still finalizing the allocation of the purchase price, which may be subject to change as additional information becomes available to us.

The following table sets forth the components of identifiable intangible assets acquired and their estimated useful lives as of the date of acquisition (in thousands, except useful life):

	Fair Value	Useful Life (months)
Developed technology	$3,500	48
Other acquired intangible assets	300	24
Total intangible assets acquired	$3,800	

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Goodwill

There were no impairments to goodwill during the three or nine months ended October 31, 2017 or during prior periods. Goodwill balances are presented below (in thousands):

	Carrying amount
Balance as of January 31, 2017	$124,642
Goodwill acquired	36,740
Balance as of October 31, 2017	$161,382

Intangible Assets

Intangible assets subject to amortization realized from acquisitions as of October 31, 2017 are as follows (in thousands, except useful life):

	Gross Fair Value	Accumulated Amortization	Net Book Value	Weighted Average Remaining Useful Life (months)
Developed technology	$82,500	$ (32,160)	$50,340	40
Customer relationships	1,810	(1,768)	42	8
Other acquired intangible assets	3,270	(1,218)	2,052	23
Total intangible assets subject to amortization	$87,580	$ (35,146)	$52,434	

Amortization expense from acquired intangible assets was $3.6 million and $3.0 million for the three months ended October 31, 2017 and 2016, respectively, and $10.5 million and $9.2 million for the nine months ended October 31, 2017 and 2016, respectively.

The expected future amortization expense for acquired intangible assets as of October 31, 2017 is as follows (in thousands):

Fiscal Period:	
Remaining three months of fiscal 2018	$4,295
Fiscal 2019	16,458
Fiscal 2020	15,740
Fiscal 2021	12,646
Fiscal 2022	3,295
Total amortization expense	$52,434

(6) Debt Financing Facilities

On May 9, 2013, we entered into a Loan Agreement with Silicon Valley Bank, which was most recently amended in May 2017. As amended, the agreement provides for a revolving line of credit facility, which expires May 9, 2018. Under the agreement, we are able to borrow up to $25 million. Interest on any drawdown under the revolving line of credit accrues either at the prime rate (4.25% in October 2017) or the LIBOR rate plus 2.75%. As of October 31, 2017, we had no balance outstanding under this agreement. The agreement contains customary financial covenants and other affirmative and negative covenants. We were in compliance with all covenants as of October 31, 2017.

(7) Stock Compensation Plans

The following table summarizes the stock option, restricted stock unit (“RSU”) and performance unit (“PSU”) award activity during the nine months ended October 31, 2017:

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		Options Outstanding				RSUs and PSUs Outstanding
	Shares Available for Grant	Shares	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value [1] (in thousands)	Shares
Balances as of January 31, 2017	10,401,789	2,057,894	$ 4.67	3.28	$ 109,571	13,924,414
Additional shares authorized	6,858,474					
Options exercised		(926,448)	2.67			
Options forfeited and expired	6,172	(6,172)	50.38			
RSUs and PSUs granted	(2,588,296)					2,588,296
RSUs and PSUs vested						(3,905,456)
Shares withheld related to net share settlement of RSUs and PSUs	1,427,592					
RSUs and PSUs forfeited and canceled	1,508,008					(1,508,008)
Balances as of October 31, 2017	17,613,739	1,125,274	$ 6.06	3.00	$ 68,908	11,099,246
Vested and expected to vest		1,125,234	$ 6.06	3.00	$ 68,905	10,768,270
Exercisable as of October 31, 2017		1,107,822	$ 6.14	2.94	$ 67,756	

[1] The intrinsic value is calculated as the difference between the exercise price of the underlying stock option award and the closing market price of our common stock as of October 31, 2017.

Under net settlement procedures applicable to our outstanding RSUs for current employees, upon each settlement date, RSUs are withheld to cover the required withholding tax, which is based on the value of the RSU on the settlement date as determined by the closing price of our common stock on the trading day of the applicable settlement date. These shares withheld by us as a result of the net settlement of RSUs are not considered issued and outstanding, thereby reducing our shares outstanding used to calculate earnings per share. These shares are returned to the reserves and are available for future issuance under our 2012 Equity Incentive Plan.

Beginning in fiscal 2016, we granted PSUs to certain executives under our 2012 Equity Incentive Plan. The number of PSUs earned and eligible to vest will be determined after a one-year performance period, based on achievement of certain company financial performance measures and the recipient's continued service with us. The number of shares of our stock to be received at vesting can range from 0% to 200% of the target amount. Compensation expense for PSUs is measured using the fair value at the date of grant and recorded over the vesting period under the graded-vesting attribution method, and may be adjusted over the vesting period based on interim estimates of performance against the pre-set objectives.

At October 31, 2017, total unrecognized compensation cost related to stock options was $0.9 million, adjusted for estimated forfeitures, which is expected to be recognized over a weighted-average period of 0.9 years. At October 31, 2017, total unrecognized compensation cost was $459.7 million related to RSUs, adjusted for estimated forfeitures, which is expected to be recognized over the next 2.5 years. At October 31, 2017, total unrecognized compensation cost was $22.8 million related to PSUs, adjusted for estimated forfeitures, which is expected to be recognized over the next 2.7 years. Additionally, during fiscal 2016, we issued 671,782 restricted shares of our common stock (“RSAs”) and at October 31, 2017, total unrecognized compensation cost was $3.8 million related to RSAs, adjusted for estimated forfeitures, which is expected to be recognized over the next 1.2 years. At October 31, 2017, 418,685 RSAs were vested, 186,003 RSAs were forfeited and canceled and 67,094 RSAs were outstanding.

The total intrinsic value of options exercised during the nine months ended October 31, 2017 was $55.4 million. The weighted-average grant date fair value of RSUs granted was $62.53 per share for the nine months ended October 31, 2017. The weighted-average grant date fair value of PSUs granted was $60.25 per share for the nine months ended October 31, 2017. The weighted-average grant date fair value of RSAs granted during fiscal 2016 was $69.00 per share. No RSAs were granted during the nine months ended October 31, 2017.

(8) Geographic Information

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Revenues

Revenues by geography are based on the shipping address of the customer. The following table presents our revenues by geographic region for the periods presented (in thousands):

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2017	2016	2017	2016
United States	$250,129	$190,123	$645,381	$493,001
International	78,524	54,666	205,684	150,493
Total revenues	$328,653	$244,789	$851,065	$643,494

Other than the United States, no other individual country exceeded 10% of total revenues during any of the periods presented. One channel partner represented 29% and 27% of total revenues during the three months ended October 31, 2017 and 2016, respectively, and approximately 28% and 25% of total revenues during the nine months ended October 31, 2017 and 2016, respectively. A second channel partner represented approximately 24% and 21% of total revenues during the three months ended October 31, 2017 and 2016, respectively, and approximately 20% and 18% of total revenues during the nine months ended October 31, 2017 and 2016, respectively. The revenues from these channel partners are comprised of a number of customer transactions, none of which were individually greater than 10% of total revenues for the three months or nine months ended October 31, 2017 or 2016.

At October 31, 2017, one channel partner represented 30% and a second channel partner represented 27% of total accounts receivable. At January 31, 2017, one channel partner represented 30% of total accounts receivable.

Property and Equipment

The following table presents our property and equipment, net of depreciation, by geographic region for the periods presented (in thousands):

	As of October 31, 2017	January 31, 2017
United States	$155,076	$ 159,428
International	6,173	6,967
Total property and equipment, net	$161,249	$ 166,395

Other than the United States, no other country represented 10% or more of our total property and equipment as of October 31, 2017 or January 31, 2017.

(9) Income Taxes

For the three months ended October 31, 2017 and 2016, we recorded a $0.2 million income tax benefit and $1.4 million of income tax expense, respectively. For the nine months ended October 31, 2017 and 2016, we recorded $1.5 million and $3.7 million of income tax expense, respectively. The decrease in income tax expense for the three and nine months ended October 31, 2017 was primarily due to the partial release of the valuation allowance as a result of our acquisitions.

During the nine months ended October 31, 2017, there were no material changes to our unrecognized tax benefits, and we do not expect to have any significant changes to unrecognized tax benefits through the end of the fiscal year. Because of our history of tax losses, all years remain open to tax audit.

(10) Net Loss Per Share

Basic net loss per share is computed by dividing the net loss by the weighted-average number of shares of common stock outstanding during the period, less the weighted-average unvested common stock subject to repurchase or forfeiture. Diluted net loss per share is computed by giving effect to all potential shares of common stock, including preferred stock, stock options, RSUs, PSUs and RSAs to the extent dilutive.

The following table sets forth the computation of historical basic and diluted net loss per share (in thousands, except per share data):

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	Three Months Ended October 31,		Nine Months Ended October 31,	
	2017	2016	2017	2016
Numerator:				
Net loss	$(50,602)	$(93,491)	$(234,033)	$(280,984)
Denominator:				
Weighted-average common shares outstanding	140,482	135,077	139,174	133,613
Less: Weighted-average unvested common shares subject to repurchase or forfeiture	(69)	(400)	(63)	(340)
Weighted-average shares used to compute net loss per share, basic and diluted	140,413	134,677	139,111	133,273
Net loss per share, basic and diluted	$(0.36)	$(0.69)	$(1.68)	$(2.11)

Since we were in a net loss position for all periods presented, basic net loss per share is the same as diluted net loss per share for all periods as the inclusion of all potentially dilutive securities outstanding would have been anti-dilutive. Potentially dilutive securities that were not included in the diluted per share calculations because they would be anti-dilutive were as follows (in thousands):

	As of October 31,	
	2017	2016
Shares subject to outstanding common stock options	1,125	2,344
Shares subject to outstanding RSUs, PSUs and RSAs	11,166	13,178
Employee stock purchase plan	360	330
Total	12,651	15,852

(11) Related Party Transactions

Certain members of our board of directors serve on the board of directors of and/or are executive officers of, and, in some cases, are investors in, companies that are customers or vendors of ours. Certain of our executive officers also serve on the board of directors of companies that are customers or vendors of ours. All contracts with related parties are executed in the ordinary course of business. We recognized revenues from sales to these companies of $3.0 million and $2.4 million for the three months ended October 31, 2017 and 2016, respectively, and $9.1 million and $4.8 million for the nine months ended October 31, 2017 and 2016, respectively. We recorded $0.6 million in expenses related to purchases from these companies during the three months ended October 31, 2017 and no expenses related to purchases from these companies during the three months ended October 31, 2016. We recorded $1.1 million and $0.2 million in expenses related to purchases from these companies during the nine months ended October 31, 2017 and 2016, respectively. We had $9.9 million and $1.9 million of accounts receivable from these companies as of October 31, 2017 and January 31, 2017, respectively. We had $0.3 million of accounts payable to these companies as of October 31, 2017 and no accounts payable to these companies as of January 31, 2017.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q. The following discussion and analysis contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. Statements that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements are often identified by

the use of words such as, but not limited to, “anticipate,” “believe,” “can,” “continue,” “could,” “estimate,” “expect,” “predict,’
“may,” “might,” “plan,” “project,” “potential,” “seek,” “should,” “target,” “will,” “would” and similar expressions or variation
identify forward-looking statements. Such statements include, but are not limited to, statements concerning our market opportunity, our future financial and operating results; our planned investments, particularly in our product development efforts; our planned expansion of our sales and marketing organization; our expectation that we will continue to use acquisitions to contribute to our growth objectives; our growth and product integration strategies; our continued efforts to market and sell both domestically and internationally; our expectations about seasonal trends; our expectations regarding our revenues mix; our expectations regarding our cost of revenues and gross margin; use of non-GAAP (as defined below) financial measures; our expectations regarding our operating expenses, including increases in research and development, sales and marketing, and

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general and administrative expenses; our expectations regarding our capital expenditures; sufficiency of cash to meet cash needs for at least the next 12 months; exposure to interest rate changes; inflation; anticipated income tax rates; our expectations regarding our leases; exposure to exchange rate fluctuations and our ability to manage such exposure; and our expected cash flows and liquidity.

These statements are based on the beliefs and assumptions of our management based on information currently available to us. Such forward-looking statements are subject to risks, uncertainties and other important factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section titled “Risk Factors” included under Part II, Item 1A below. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances that occur after the date of this report.

Overview

Splunk provides innovative software solutions that enable organizations to gain real-time operational intelligence by harnessing the value of their data. Our offerings enable users to collect, index, search, explore, monitor, correlate and analyze data regardless of format or source. Our offerings address large and diverse data sets commonly referred to as big data and are specifically tailored for machine data. Machine data is produced by nearly every software application and electronic device in an organization and contains a definitive, time-stamped record of various activities, such as transactions, customer and user activities, and security threats. Beyond an organization's traditional information technology (“IT”) and security infrastructure, data from the industrial internet, including industrial control systems, sensors, SCADA systems, networks, manufacturing systems, smart meters and Internet-of-Things ("IoT"), which includes consumer-oriented systems, such as electronic wearables, mobile devices, automobiles and medical devices, are also continuously generating machine data. Our offerings help organizations gain value from all of these different sources and forms of machine data.

We believe the market for products that provide operational intelligence presents a substantial opportunity as data grows in volume and diversity, creating new risks, opportunities and challenges for organizations. Since our inception, we have invested a substantial amount of resources developing our offerings to address this market, specifically with respect to machine data.

Our offerings are designed to deliver rapid return-on-investment for our customers. They generally do not require customization, long deployment cycles or extensive professional services commonly associated with traditional enterprise software applications. Prospective users can get started with our free online sandboxes that enable our customers to immediately try and experience Splunk offerings. Users that prefer to deploy the software on-premises can take advantage of our free 60-day trial of Splunk Enterprise, which converts into a limited free perpetual license of up to 500 megabytes of data per day. Paying users can sign up for Splunk Cloud and avoid the need to provision, deploy and manage internal infrastructure. Alternatively, they can simply download and install the software, typically in a matter of hours, to connect to their relevant machine data sources. Customers can also provision a compute instance on Amazon Web Services via a pre-built Amazon Machine Image, which delivers a pre-configured virtual machine instance with our Splunk Enterprise software. In fiscal 2017, we introduced free development-test licenses for certain commercial customers, allowing users to explore new data and use cases in a non-production environment without incurring additional fees. We also offer support, training and professional services to our customers to assist in the deployment of our software.

For Splunk Enterprise, we base our license fees on the estimated daily data indexing capacity our customers require. A substantial portion of our license revenues consist of revenues from perpetual licenses, whereby we generally

recognize the license fee portion of these arrangements upfront. As a result, the timing of when we enter into large perpetual licenses may lead to fluctuations in our revenues and operating results because our expenses are largely fixed in the short-term. Additionally, we license our software under term licenses, which are generally recognized ratably over the contract term. From time to time, we also enter into transactions that are designed to enable broad adoption of our software within an enterprise, referred to as enterprise adoption agreements. These agreements often include provisions that require revenue deferral and recognition over time.

Splunk Cloud delivers the core capabilities of Splunk Enterprise as a scalable, reliable cloud service. Splunk Cloud customers pay an annual subscription fee based on the combination of the volume of data indexed per day and the length of the data retention period. Splunk Light provides log search and analysis that is designed, priced and packaged for small IT environments, where a single-server log analytics solution is sufficient. Splunk Enterprise Security ("ES") addresses emerging security threats and security information and event management ("SIEM") use cases through monitoring, alerts and analytics. Splunk IT Service Intelligence ("ITSI") monitors the health and key performance indicators of critical IT and business services.

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Splunk User Behavior Analytics ("UBA") detects cyber-attacks and insider threats using data science, machine learning and advanced correlation.

We intend to continue investing for long-term growth. We have invested and intend to continue to invest heavily in product development to deliver additional features and performance enhancements, deployment models and solutions that can address new end markets. For example, we released new versions of existing offerings such as Splunk Enterprise and introduced new offerings for the security and IT markets during fiscal 2017. In addition, we expect to continue to aggressively expand our sales and marketing organizations to market and sell our software both in the United States and internationally. We have utilized and expect to continue to utilize acquisitions to contribute to our long-term growth objectives.

Our goal is to make our software the platform for delivering operational intelligence and real-time business insights from machine data. The key elements of our growth strategy are to:

- Extend our technological capabilities.
- Continue to expand our direct and indirect sales organization, including our channel relationships, to increase our sales capacity and enable greater market presence.
- Further penetrate our existing customer base and drive enterprise-wide adoption.
- Enhance our value proposition through a focus on solutions which address core and expanded use cases.
- Grow our user communities and partner ecosystem to increase awareness of our brand, target new use cases, drive operational leverage and deliver more targeted, higher value solutions.
- Continue to deliver a rich developer environment to enable rapid development of enterprise applications that leverage machine data and the Splunk platform.

We believe the factors that will influence our ability to achieve our goals include, among other things, our ability to deliver new offerings as well as additional product functionality; acquire new customers across geographies and industries; cultivate incremental sales from our existing customers by driving increased use of our software within organizations; provide additional solutions that leverage our core machine data platform to help organizations understand and realize the value of their machine data in specific end markets and use cases; add additional original equipment manufacturer ("OEM") and strategic relationships to enable new sales channels for our software as well as extend our integration with third-party products; help software developers leverage the functionality of our machine data platform through software development kits ("SDKs") and application programming interfaces ("APIs"); and successfully integrate acquired businesses and technologies.

Financial Summary

For the three months ended October 31, 2017 and 2016, our total revenues were $328.7 million and $244.8 million, respectively. For the three months ended October 31, 2017 and 2016, approximately 24% and 22% of our total revenues, respectively, were derived from customers located outside the United States. Our customers and end-users represent the public sector and a wide variety of industries, including financial services, manufacturing, retail and technology, among others. As of October 31, 2017, we had over 14,000 customers, including over 85 of the Fortune 100 companies.

For the three months ended October 31, 2017 and 2016, our GAAP operating loss was $50.8 million and $91.0 million, respectively. Our non-GAAP operating income was $32.3 million and $16.7 million for the three months ended October 31, 2017 and 2016, respectively.

For the three months ended October 31, 2017 and 2016, our GAAP net loss was $50.6 million and $93.5 million, respectively. Our non-GAAP net income was $25.1 million and $13.9 million for the three months ended October 31, 2017 and 2016, respectively.

Our quarterly results reflect seasonality in the sale of our offerings. Historically, a pattern of increased license sales in the fourth fiscal quarter as a result of industry buying patterns has positively impacted sales activity in that period, which can result in lower sequential revenues in the following first fiscal quarter. However, adoption of the new revenue recognition standard may affect our revenue trends. Our gross margins and operating losses have been affected by these historical trends because the majority of our expenses are relatively fixed in the short-term. The majority of our expenses are personnel-related

and include salaries, stock-based compensation, benefits and incentive-based compensation plan expenses. As a result, we have not experienced significant seasonal fluctuations in the timing of expenses from period to period.

Non-GAAP Financial Results

To supplement our condensed consolidated financial statements, which are prepared and presented in accordance with GAAP, we provide investors with certain non-GAAP financial measures, including non-GAAP cost of revenues, non-GAAP gross margin, non-GAAP research and development expense, non-GAAP sales and marketing expense, non-GAAP general and administrative expense, non-GAAP operating income (loss), non-GAAP operating margin, non-GAAP net income (loss) and non-GAAP net income (loss) per share (collectively the "non-GAAP financial measures"). These non-GAAP financial measures exclude all or a combination of the following (as reflected in the following reconciliation tables): expenses related to stock-based compensation and related employer payroll tax, amortization of acquired intangible assets, adjustments related to a financing lease obligation, adjustments related to facility exits and acquisition-related adjustments, including the partial release of the valuation allowance due to acquisitions. The adjustments for the financing lease obligation are to reflect the expense we would have recorded if our build-to-suit lease arrangement had been deemed an operating lease instead of a financing lease and is calculated as the net of actual ground lease expense, depreciation and interest expense over estimated straight-line rent expense. The non-GAAP financial measures are also adjusted for our estimated tax rate on non-GAAP income (loss). To determine the annual non-GAAP tax rate, we evaluate a financial projection based on our non-GAAP results. The annual non-GAAP tax rate takes into account other factors including our current operating structure, our existing tax positions in various jurisdictions and key legislation in major jurisdictions where we operate. The annual non-GAAP tax rate applied to the three and nine months ended October 31, 2017 was 27%. We will utilize this annual non-GAAP tax rate in fiscal 2018 and will provide updates to this rate on an annual basis, or more frequently if material changes occur. In addition, non-GAAP financial measures include free cash flow, which represents cash from operations less purchases of property and equipment, and billings, which represents revenues plus the change in deferred revenue during the period. The presentation of the non-GAAP financial measures is not intended to be considered in isolation or as a substitute for, or superior to, the financial information prepared and presented in accordance with GAAP. We use these non-GAAP financial measures for financial and operational decision-making purposes and as a means to evaluate period-to-period comparisons. We believe that these non-GAAP financial measures provide useful information about our operating results, enhance the overall understanding of past financial performance and future prospects and allow for greater transparency with respect to key metrics used by management in our financial and operational decision making. In addition, these non-GAAP financial measures facilitate comparisons to competitors' operating results.

We exclude stock-based compensation expense because it is non-cash in nature and excluding this expense provides meaningful supplemental information regarding our operational performance and allows investors the ability to make more meaningful comparisons between our operating results and those of other companies. We exclude employer payroll tax expense related to employee stock plans in order for investors to see the full effect that excluding that stock-based compensation expense had on our operating results. These expenses are tied to the exercise or vesting of underlying equity awards and the price of our common stock at the time of vesting or exercise, which may vary from period to period independent of the operating performance of our business. We also exclude amortization of acquired intangible assets, adjustments related to facility exits, acquisition-related costs, including the partial release of the valuation allowance due to acquisitions, and make adjustments related to a financing lease obligation from our non-GAAP financial measures because these are considered by management to be outside of our core operating results. Accordingly, we believe that excluding these expenses provides investors and management with greater visibility to the underlying performance of our business operations, facilitates comparison of our results with other periods and may also facilitate comparison with the results of other companies in our industry. 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 can be used for strategic opportunities, including investing in our business, making

strategic acquisitions and strengthening our balance sheet. We consider billings to be a useful measure for management and investors because it provides visibility into our sales activity for a particular period, which is not necessarily reflected in our revenues given that we recognize term licenses and subscriptions for cloud services ratably.

There are limitations in using non-GAAP financial measures because the non-GAAP financial measures are not prepared in accordance with GAAP, may be different from non-GAAP financial measures used by our competitors and exclude expenses that may have a material impact upon our reported financial results. Further, stock-based compensation expense has been and will continue to be for the foreseeable future a significant recurring expense in our business and an important part of the compensation provided to our employees. The non-GAAP financial measures are meant to supplement and be viewed in conjunction with GAAP financial measures.

The following table reconciles our net cash provided by operating activities to free cash flow for the three and nine months ended October 31, 2017, and 2016 (in thousands):

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	Three Months Ended October 31, 2017	Three Months Ended October 31, 2016	Nine Months Ended October 31, 2017	Nine Months Ended October 31, 2016
Net cash provided by operating activities	$52,287	$45,272	$116,833	$99,310
Less purchases of property and equipment	(5,418)	(12,969)	(13,931)	(27,219)
Free cash flow (non-GAAP)	$46,869	$32,303	$102,902	$72,091
Net cash used in investing activities	$(49,007)	$(64,224)	$(77,175)	$(108,227)
Net cash used in financing activities	$(29,538)	$(25,257)	$(68,194)	$(50,266)

The following table reconciles our GAAP to Non-GAAP Financial Measures for the three months ended October 31, 2017 (in thousands, except per share amounts):

	GAAP	Stock-based compensation and related employer payroll tax	Amortization of acquired intangible assets	Adjustments related to financing lease obligation	Adjustments related to facility exits	Acquisition-related adjustments	Income tax effects related to non-GAAP adjustments [3]	Non-GAAP
Cost of revenues	$64,167	$(8,116)	$(2,873)	$316	$—	$—	$—	$53,494
Gross margin	80.5 %	2.4 %	0.9 %	(0.1)%	— %	— %	— %	83.7 %
Research and development	74,080	(25,502)	(130)	489	—	—	—	48,937
Sales and marketing	205,364	(37,789)	(561)	1,170	—	—	—	168,184
General and administrative	35,857	(14,882)	—	230	5,191	(643)	—	25,753
Operating income (loss)	(50,815)	86,289	3,564	(2,205)	(5,191)	643	—	32,285
Operating margin	(15.5)%	26.3 %	1.1 %	(0.7)%	(1.6)%	0.2 %	— %	9.8 %
Income tax provision	(232)	—	—	—		1,995	7,514	9,277
Net income (loss)	$(50,602)	$86,289	$3,564	$(111) [2]	$(5,191)	$(1,352)	$(7,514)	$25,083
Net income (loss) per share[1]	$(0.36)							$0.17

[1] GAAP net loss per share calculated based on 140,413 weighted-average shares of common stock. Non-GAAP net income per share calculated based on 144,415 diluted weighted-average shares of common stock, which includes 4,002 potentially dilutive shares related to employee stock awards. GAAP to non-GAAP net income (loss) per share is not reconciled due to the difference in the number of shares used to calculate basic and diluted weighted-average shares of common stock.
[2] Includes $2.1 million of interest expense related to the financing lease obligation.
[3] Represents the tax effect of the non-GAAP adjustments based on the estimated annual effective tax rate of 27%.

The following table reconciles our GAAP to non-GAAP Financial Measures for the three months ended October 31, 2016 (in thousands, except per share amounts):

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	GAAP	Stock-based compensation and related employer payroll tax	Amortization of acquired intangible assets	Adjustments related to financing lease obligation	Income tax effects related to non-GAAP adjustments (3)	Non-GAAP
Cost of revenues	$48,674	$ (7,740)	$ (2,814)	$ 276	$ —	$ 38,396
Gross margin	80.1 %	3.2 %	1.1 %	(0.1)%	— %	84.3 %
Research and development	85,659	(45,889)	(63)	559	—	40,266
Sales and marketing	167,330	(39,462)	(110)	1,124	—	128,882
General and administrative	34,079	(13,803)	—	236	—	20,512
Operating income (loss)	(90,953)	106,894	2,987	(2,195)	—	16,733
Operating margin	(37.2)%	43.7 %	1.2 %	(0.9)%	— %	6.8 %
Income tax provision	1,367	—	—	—	2,336	3,703
Net income (loss)	$(93,491)	$ 106,894	$ 2,987	$ (123) (2)	$ (2,336)	$ 13,931
Net income (loss) per share(1)	$(0.69)					$ 0.10

(1) GAAP net loss per share calculated based on 134,677 weighted-average shares of common stock. Non-GAAP net income per share calculated based on 138,401 diluted weighted-average shares of common stock, which includes 3,724 potentially dilutive shares related to employee stock awards. GAAP to Non-GAAP net income (loss) per share is not reconciled due to the difference in the number of shares used to calculate basic and diluted weighted-average shares of common stock.
(2) Includes $2.1 million of interest expense related to the financing lease obligation.
(3) For consistency, prior year non-GAAP net loss has been adjusted to reflect the tax effect of the non-GAAP adjustments based on the annual effective tax rate of 21%.

The following table reconciles our GAAP to non-GAAP Financial Measures for the nine months ended October 31, 2017 (in thousands, except per share amounts):

	GAAP	Stock-based compensation and related employer payroll tax	Amortization of acquired intangible assets	Adjustments related to financing lease obligation	Adjustments related to facility exits	Acquisition-related adjustments	Income tax effects related to non-GAAP adjustments (3)	Non-GAAP
Cost of revenues	$182,206	$(25,436)	$(8,392)	$931	$—	$—	$—	$149,309
Gross margin	78.6 %	3.0 %	1.0 %	(0.1)%	— %	— %	— %	82.5 %
Research and development	217,152	(80,100)	(213)	1,515	—	—	—	138,354
Sales and marketing	570,596	(124,041)	(1,893)	3,514	—	—	—	448,176
General and administrative	111,492	(45,673)	—	694	5,191	(643)	—	71,061
Operating income (loss)	(230,381)	275,250	10,498	(6,654)	(5,191)	643	—	44,165
Operating margin	(27.1)%	32.4 %	1.2 %	(0.8)%	(0.6)%	0.1 %	— %	5.2 %
Income tax provision	1,459	—	—	—	—	2,540	9,038	13,037

Net income (loss)	$(234,033)	$275,250	$10,498	$(339) [2]	$(5,191)	$(1,897)	$(9,038)	$35,250
Net income (loss) per share[1]	$(1.68)							$0.25

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[1] GAAP net loss per share calculated based on 139,111 weighted-average shares of common stock. Non-GAAP net income per share calculated based on 143,552 diluted weighted-average shares of common stock, which includes 4,441 potentially dilutive shares related to employee stock awards. GAAP to non-GAAP net income (loss) per share is not reconciled due to the difference in the number of shares used to calculate basic and diluted weighted-average shares of common stock.

[2] Includes $6.3 million of interest expense related to the financing lease obligation.

[3] Represents the tax effect of the non-GAAP adjustments based on the estimated annual effective tax rate of 27%.

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The following table reconciles our GAAP to non-GAAP Financial Measures for the nine months ended October 31, 2016 (in thousands, except per share amounts):

	GAAP	Stock-based compensation and related employer payroll tax	Amortization of acquired intangible assets	Adjustments related to financing lease obligation	Income tax effects related to non-GAAP adjustments (3)	Non-GAAP
Cost of revenues	$132,790	$ (23,075)	$ (8,612)	$ 561	$ —	$101,664
Gross margin	79.4 %	3.6 %	1.3 %	(0.1)%	— %	84.2 %
Research and development	220,254	(104,269)	(193)	1,172	—	116,964
Sales and marketing	462,709	(120,883)	(412)	2,373	—	343,787
General and administrative	100,464	(43,448)	—	513	—	57,529
Operating income (loss)	(272,723)	291,675	9,217	(4,619)	—	23,550
Operating margin	(42.4)%	45.4 %	1.4 %	(0.7)%	— %	3.7 %
Income tax provision	3,702	—	—	—	1,465	5,167
Net income (loss)	$(280,984)	$ 291,675	$ 9,217	$ 994 (2)	$ (1,465)	$19,437
Net income (loss) per share(1)	$(2.11)					$0.14

(1) GAAP net loss per share calculated based on 133,273 weighted-average shares of common stock. Non-GAAP net income per share calculated based on 136,690 diluted weighted-average shares of common stock, which includes 3,417 potentially dilutive shares related to employee stock awards. GAAP to Non-GAAP net income (loss) per share is not reconciled due to the difference in the number of shares used to calculate basic and diluted weighted-average shares of common stock.
(2) Includes $5.6 million of interest expense related to the financing lease obligation.
(3) For consistency, prior year non-GAAP net loss has been adjusted to reflect the tax effect of the non-GAAP adjustments based on the annual effective tax rate of 21%.

The following table reconciles our total revenues to billings for the three and nine months ended October 31, 2017, and 2016 (in thousands):

	Three Months Ended		Nine Months Ended	
	October 31, 2017	October 31, 2016	October 31, 2017	October 31, 2016
Total revenues	$328,653	$244,789	$851,065	$643,494
Increase in deferred revenue	52,913	31,796	76,654	49,652
Billings (non-GAAP)	$381,566	$276,585	$927,719	$693,146

Components of Operating Results

Revenues

License revenues. License revenues reflect the revenues recognized from sales of licenses to new customers and additional licenses to existing customers. We are focused on acquiring new customers and increasing revenues from our existing customers as they realize the value of our software by indexing higher volumes of machine data and expanding the use of our software through additional use cases and broader deployment within their organizations. A majority of our license revenues consists of revenues from perpetual licenses, under which we generally recognize the

license fee portion of the arrangement upfront, assuming all revenue recognition criteria are satisfied. Customers can also purchase term license agreements, under which we recognize the license fee ratably, on a straight-line basis, over the term of the license. Due to the differing revenue recognition policies, shifts in the mix between transactions that are recognized upfront and those that are recognized ratably from quarter to quarter could produce substantial variation in revenues recognized even if our sales remain consistent. In addition, seasonal trends that contribute to increased sales activity in the fourth fiscal quarter often result in lower sequential revenues in the first fiscal quarter, and we expect this trend to continue. Comparing our revenues on a period-to-period basis may not be meaningful, and you should not rely on our past results as an indication of our future performance. Our historical methods of revenue recognition will be materially affected by the adoption of a new revenue recognition standard in

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the first quarter of 2019. Please see Note 1 contained in the "Notes to Condensed Consolidated Financial Statements" included in Part I of this Quarterly Report on Form 10-Q for further information.

Maintenance and services revenues. Maintenance and services revenues consist of revenues from maintenance agreements and, to a lesser extent, professional services and training, as well as revenues from our cloud services. Typically, when purchasing a perpetual license, a customer also purchases one year of maintenance service for which we charge a percentage of the license fee. When a term license is purchased, maintenance service is typically bundled with the license for the term of the license period. Customers with maintenance agreements are entitled to receive support and unspecified upgrades and enhancements when and if they become available during the maintenance period. We recognize the revenues associated with maintenance agreements ratably, on a straight-line basis, over the associated maintenance period. In arrangements involving a term license, we recognize both the license and maintenance revenues over the contract period. We have a professional services organization focused on helping our customers deploy our software in highly complex operational environments and train their personnel. We recognize the revenues associated with these professional services on a time and materials basis as we deliver the services or provide the training. We expect maintenance and services revenues to become a larger percentage of our total revenues as our installed customer base grows. We generally recognize the revenues associated with our cloud services ratably, on a straight-line basis, over the associated subscription term.

Professional services and training revenues, as a percentage of total revenues, were 10% and 9% for the three months ended October 31, 2017 and 2016, respectively. We have experienced continued growth in our professional services revenues primarily due to the deployment of our software with some customers that have large, highly complex IT environments.

Cost of Revenues

Cost of license revenues. Cost of license revenues includes all direct costs to deliver our products, including salaries, benefits, stock-based compensation and related expenses such as employer taxes, allocated overhead for facilities and IT and amortization of acquired intangible assets. We recognize these expenses as they are incurred.

Cost of maintenance and services revenues. Cost of maintenance and services revenues includes salaries, benefits, stock-based compensation and related expenses such as employer taxes for our maintenance and services organization, allocated overhead for depreciation of equipment, facilities and IT, amortization of acquired intangible assets and third-party hosting fees related to our cloud services. We recognize expenses related to our maintenance and services organization as they are incurred.

Operating Expenses

Our operating expenses are classified into three categories: research and development, sales and marketing and general and administrative. For each category, the largest component is personnel costs, which include salaries, employee benefit costs, bonuses, commissions as applicable, stock-based compensation and related expenses such as employer taxes. Operating expenses also include allocated overhead costs for depreciation of equipment, facilities and IT. Allocated costs for facilities include costs for compensation of our facilities personnel, leasehold improvements and rent. Our allocated costs for IT include costs for compensation of our IT personnel and costs associated with our IT infrastructure. Operating expenses are generally recognized as incurred.

Research and development. Research and development expenses primarily consist of personnel and facility-related costs attributable to our research and development personnel. We have devoted our product development efforts primarily to enhancing the functionality and expanding the capabilities of our software and services. We expect that our research and development expenses will continue to increase, in absolute dollars, as we increase our research and

development headcount to further strengthen and enhance our software and services and invest in the development of our solutions and apps.

Sales and marketing. Sales and marketing expenses primarily consist of personnel and facility-related costs for our sales, marketing and business development personnel, commissions earned by our sales personnel, and the cost of marketing and business development programs. We expect that sales and marketing expenses will continue to increase, in absolute dollars, as we continue to hire additional personnel and invest in marketing programs.

General and administrative. General and administrative expenses primarily consist of personnel and facility-related costs for our executive, finance, legal, human resources and administrative personnel; our legal, accounting and other professional services fees; and other corporate expenses. We anticipate continuing to incur additional expenses due to growing our operations, including higher legal, corporate insurance and accounting expenses.

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Interest and other income (expense), net

Interest and other income (expense), net consists primarily of foreign exchange gains and losses, interest income on our investments and cash and cash equivalents balances, and changes in the fair value of forward exchange contracts.

Provision for income taxes

The provision for income taxes consists of federal, state and foreign income taxes. We recognize deferred tax assets and liabilities for the expected tax consequences of temporary differences between the tax basis of assets and liabilities and their reported amounts using enacted tax rates in effect for the year in which we expect the differences to reverse. We record a valuation allowance to reduce the deferred tax assets to the amount that we are more-likely-than-not to realize. Because of our history of U.S. net operating losses, we have established, in prior years, a full valuation allowance against potential future benefits for U.S. deferred tax assets including loss carry-forwards and research and development and other tax credits. We regularly assess the likelihood that our deferred income tax assets will be realized based on the realization guidance available. To the extent that we believe any amounts are not more-likely-than-not to be realized, we record a valuation allowance to reduce the deferred income tax assets. We regularly assess the need for the valuation allowance on our deferred tax assets, and to the extent that we determine that an adjustment is needed, such adjustment will be recorded in the period that the determination is made.

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Results of Operations

The following tables set forth our results of operations for the periods presented and as a percentage of our total revenues for those periods. The period-to-period comparison of financial results is not necessarily indicative of financial results to be achieved in future periods.

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2017	2016	2017	2016
	(in thousands)			
Condensed Consolidated Statements of Operations Data:				
Revenues				
License	$179,829	$139,725	$439,406	$356,412
Maintenance and services	148,824	105,064	411,659	287,082
Total revenues	328,653	244,789	851,065	643,494
Cost of revenues				
License	3,013	2,883	9,100	8,713
Maintenance and services	61,154	45,791	173,106	124,077
Total cost of revenues	64,167	48,674	182,206	132,790
Gross profit	264,486	196,115		