

RingCentral Inc
Form 10-Q
November 08, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2018

OR

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

For the transition period from _____ to _____

Commission File Number: 001-36089

RingCentral, Inc.

(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or other jurisdiction) 94-3322844
(I.R.S. Employer
of incorporation or organization) Identification No.)

20 Davis Drive

Belmont, California 94002

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(Address of principal executive offices)

(650) 472-4100

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically, every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
Emerging growth company	

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

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

As of November 2, 2018, there were 68,578,598 shares of Class A Common Stock issued and outstanding and 11,754,332 shares of Class B Common Stock issued and outstanding.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements that are based on our management's beliefs and assumptions and on information currently available to our management. The forward-looking statements are contained principally in, but not limited to, the sections entitled "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations". Forward-looking statements include all statements that are not historical facts and can be identified by terms such as "anticipates", "believes", "could", "seeks", "estimates", "expects", "intends", "may", "plans", "potential", "predicts", "projects", "should", "will", "would" or similar expressions and the negative terms. Forward-looking statements include, but are not limited to, statements about:

- our progress against short-term and long-term goals;
- our future financial performance;
- our anticipated growth, growth strategies and our ability to effectively manage that growth and effect these strategies;
- our success in the enterprise market;
- anticipated trends, developments and challenges in our business and in the markets in which we operate, as well as general macroeconomic conditions;
- our ability to scale to our desired goals, particularly the implementation of new processes and systems and the addition to our workforce;
- the impact of competition in our industry and innovation by our competitors;
- our ability to anticipate and adapt to future changes in our industry;
- our ability to predict software subscriptions revenues, formulate accurate financial projections, and make strategic business decisions based on our analysis of market trends;
- our ability to anticipate market needs and develop new and enhanced products and subscriptions to meet those needs, and our ability to successfully monetize them;
- maintaining and expanding our customer base;
- maintaining, expanding and responding to changes in our relationships with other companies;
- maintaining and expanding our distribution channels, including our network of sales agents and resellers;
- our success with our carrier partners;
- our ability to sell, market, and support our products and services;
- our ability to expand our business to medium-sized and larger customers as well as expanding domestically and internationally;
- our ability to realize increased purchasing leverage and economies of scale as we expand;
- the impact of seasonality on our business;
- the impact of any failure of our solutions or solution innovations;
- our reliance on our third-party product and service providers;
- the potential effect on our business of litigation to which we may become a party;
- our liquidity and working capital requirements;
- the impact of changes in the regulatory environment;
- our ability to protect our intellectual property and rely on open source licenses;
- our expectations regarding the growth and reliability of the internet infrastructure;
- the timing of acquisitions of, or making and exiting investments in, other entities, businesses or technologies;
- our ability to successfully and timely integrate, and realize the benefits of any significant acquisition we may make;
- our capital expenditure projections;

- the estimates and estimate methodologies used in preparing our condensed consolidated financial statements;
- the political environment and stability in the regions in which we or our subcontractors operate;
- the impact of economic downturns on us and our customers;
- our ability to defend our systems and our customer information from fraud and cyber attack;
- our ability to prevent the use of fraudulent payment methods for our products;
- our ability to retain key employees and to attract qualified personnel; and
- the impact of foreign currencies on our non-U.S. business as we expand our business internationally.

Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be significantly different from any future results, performance or achievements expressed or implied by the forward-looking statements. We discuss these risks in greater detail in the section entitled “Risk Factors” and elsewhere in this Quarterly Report on Form 10-Q. Given these uncertainties, you should not place undue reliance on these forward-looking statements. Also, forward-looking statements represent our management’s beliefs and assumptions only as of the date of this Quarterly Report on Form 10-Q. You should read this Quarterly Report on Form 10-Q completely and with the understanding that our actual future results may be significantly different from what we expect.

Except as required by law, we assume no obligation to update these forward-looking statements publicly, or to update the reasons actual results could differ significantly from those anticipated in these forward-looking statements, even if new information becomes available in the future.

PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

RINGCENTRAL, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited, in thousands)

	September 30, 2018	December 31, 2017 *As Adjusted
Assets		
Current assets		
Cash and cash equivalents	\$ 577,283	\$ 181,192
Accounts receivable, net	74,183	46,690
Deferred sales commission costs	20,869	15,424
Prepaid expenses and other current assets	29,823	21,512
Total current assets	702,158	264,818
Property and equipment, net	60,200	43,298
Deferred sales commission costs, noncurrent	50,263	37,871
Goodwill	9,393	9,393
Acquired intangibles, net	8,366	1,462
Other assets	11,463	2,972
Total assets	\$ 841,843	\$ 359,814
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	\$ 6,017	\$ 7,322
Accrued liabilities	85,714	54,977
Current portion of capital lease obligation	943	—
Deferred revenue	80,024	62,917
Total current liabilities	172,698	125,216
Convertible senior notes, net	361,637	—
Capital lease obligation	2,829	—
Other long-term liabilities	5,232	6,252
Total liabilities	542,396	131,468
Commitments and contingencies (Note 8)		
Stockholders' equity		
Common stock	8	8
Additional paid-in capital	526,891	434,840

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Accumulated other comprehensive income	2,573	2,998
Accumulated deficit	(230,025)	(209,500)
Total stockholders' equity	299,447	228,346
Total liabilities and stockholders' equity	\$ 841,843	\$ 359,814

* See Note 2 for a summary of adjustments.

See accompanying notes to condensed consolidated financial statements

RINGCENTRAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited, in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
		*As Adjusted		*As Adjusted
Revenues				
Software subscriptions	\$ 158,068	\$ 119,916	\$ 440,987	\$ 334,942
Other	15,757	10,363	44,013	27,490
Total revenues	173,825	130,279	485,000	362,432
Cost of revenues				
Software subscriptions	27,958	22,912	79,200	64,970
Other	11,316	7,872	33,814	22,681
Total cost of revenues	39,274	30,784	113,014	87,651
Gross profit	134,551	99,495	371,986	274,781
Operating expenses				
Research and development	26,347	19,082	73,812	54,786
Sales and marketing	86,279	61,605	237,222	172,231
General and administrative	28,952	19,073	73,984	52,885
Total operating expenses	141,578	99,760	385,018	279,902
Loss from operations	(7,027)	(265)	(13,032)	(5,121)
Other income (expense), net				
Interest expense	(4,916)	(6)	(11,163)	(94)
Other income, net	2,533	613	3,944	1,313
Other income (expense), net	(2,383)	607	(7,219)	1,219
(Loss) income before income taxes	(9,410)	342	(20,251)	(3,902)
Provision for income taxes	108	73	274	181
Net (loss) income	\$(9,518)	\$269	\$(20,525)	\$(4,083)
Net (loss) income per common share				
Basic	\$(0.12)	\$0.00	\$(0.26)	\$(0.05)
Diluted	\$(0.12)	\$0.00	\$(0.26)	\$(0.05)
Weighted-average number of shares used in computing net (loss) income per share				
Basic	79,903	76,915	79,116	75,815
Diluted	79,903	83,109	79,116	75,815

* See Note 2 for a summary of adjustments.

See accompanying notes to condensed consolidated financial statements

RINGCENTRAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

(Unaudited, in thousands)

	Three Months Ended September 30, 2018		2017		Nine Months Ended September 30, 2018		2017	
			*As Adjusted				*As Adjusted	
Net (loss) income	\$ (9,518)	\$ 269			\$ (20,525)		\$ (4,083)	
Other comprehensive loss								
Foreign currency translation adjustments	(222)	88			(425)		166	
Comprehensive (loss) income	\$ (9,740)	\$ 357			\$ (20,950)		\$ (3,917)	

* See Note 2 for a summary of adjustments.

See accompanying notes to condensed consolidated financial statements

RINGCENTRAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in thousands)

	Nine Months Ended September 30,	
	2018	2017
		*As Adjusted
Cash flows from operating activities		
Net loss	\$(20,525)	\$(4,083)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	17,194	11,929
Share-based compensation	49,379	30,504
Amortization of deferred sales commission costs	13,956	8,874
Amortization of debt discount and issuance costs	11,003	—
Foreign currency remeasurement (gain) loss	657	(700)
Provision for bad debt	2,390	1,508
Deferred income taxes	15	(18)
Other	458	123
Changes in assets and liabilities:		
Accounts receivable	(29,883)	(11,188)
Deferred sales commission costs	(31,793)	(23,402)
Prepaid expenses and other current assets	(6,256)	(6,872)
Other assets	(406)	1,419
Accounts payable	(1,128)	2,168
Accrued liabilities	27,954	9,426
Deferred revenue	17,107	11,288
Other liabilities	(1,020)	(100)
Net cash provided by operating activities	49,102	30,876
Cash flows from investing activities		
Purchases of property and equipment	(17,852)	(15,886)
Capitalized internal-use software	(8,117)	(5,432)
Cash paid for acquisition of intangible assets	(18,470)	—
Restricted investment	—	530
Net cash used in investing activities	(44,439)	(20,788)
Cash flows from financing activities		
Proceeds from issuance of convertible senior notes, net of issuance costs	449,457	—
Payments for capped call transactions and costs	(49,910)	—
Repurchase of common stock	(15,000)	—
Proceeds from issuance of stock in connection with stock plans	13,632	19,685
Taxes paid related to net share settlement of equity awards	(5,457)	(2,125)
Repayment of debt	—	(14,840)
Repayment of capital lease obligations	(741)	(181)
Net cash provided by financing activities	391,981	2,539
Effect of exchange rate changes	(553)	(676)
Net increase in cash, cash equivalents and restricted cash	396,091	11,951

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Cash, cash equivalents and restricted cash		
Beginning of period	181,192	160,355
End of period	\$577,283	\$172,306
Supplemental disclosure of cash flow data		
Cash paid for interest	\$40	\$116
Cash paid for income taxes, net of refunds	\$331	\$188
Non-cash investing and financing activities		
Reclassification from intangible assets to prepaid and other assets	\$8,223	\$—
Equipment acquired under capital lease	\$4,513	\$—
Liability for potential future payments	\$2,001	\$—
Equipment and capitalized internal-use software purchased and unpaid at period end	\$2,293	\$1,204
Issuance of common stock for achievement of Glip related matters	\$—	\$3,260

* See Note 2 for a summary of adjustments.

See accompanying notes to condensed consolidated financial statements

RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 1. Description of Business and Summary of Significant Accounting Policies

Description of Business

RingCentral, Inc. (the “Company”) is a provider of software-as-a-service (“SaaS”) solutions that enables businesses to communicate, collaborate and connect. The Company was incorporated in California in 1999 and was reincorporated in Delaware on September 26, 2013.

Basis of Presentation and Consolidation

The unaudited condensed consolidated financial statements and accompanying notes of the Company reflect all adjustments (all of which are normal, recurring in nature and those discussed in these notes) that are, in the opinion of management, necessary for a fair presentation of the interim periods presented. All intercompany balances and transactions have been eliminated in consolidation. The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for any subsequent quarter or for the entire year ending December 31, 2018. Certain information and note disclosures normally included in annual consolidated financial statements prepared in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”) have been condensed or omitted under the rules and regulations of the Securities and Exchange Commission (“SEC”).

Effective January 1, 2018, the Company adopted the requirements of Accounting Standards Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers (Topic 606), issued by the Financial Accounting Standards Board (“FASB”), as discussed in Note 2. Topic 606 also includes Subtopic 340-40, Other Assets and Deferred Costs - Contracts with Customers, which requires the deferral of incremental costs of obtaining a contract with a customer. Collectively, the Company refers to Topic 606 and Subtopic 340-40 as “Topic 606” or the “new standard.” All amounts and disclosures set forth in this Quarterly Report on Form 10-Q have been adjusted to comply with the new standard.

The unaudited condensed consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements and related notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017, filed with the SEC on February 26, 2018.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. The significant estimates made by management affect revenues, allowance for doubtful accounts, deferred sales commission costs, goodwill, share-based compensation, capitalization of internally developed software, return reserves, provision for income taxes, uncertain tax positions, loss contingencies, sales tax liabilities, and accrued liabilities. Management periodically evaluates these estimates and will make adjustments prospectively based upon the results of such periodic evaluations. Actual results could differ from these estimates.

Changes in Significant Accounting Policies

Except for the accounting policies for revenue recognition and deferred commissions that were updated as a result of adopting Topic 606, there have been no changes to our significant accounting policies described in the Annual Report on Form 10-K for the year ended December 31, 2017, that have had a material impact on the Company's condensed consolidated financial statements and related notes.

Revenue Recognition

The Company derives its revenues primarily from software subscriptions, sale of products, and professional services. Revenues are recognized when control of these services is transferred to the customers, in an amount that reflects the consideration the Company expects to be entitled to in exchange for those services.

The Company determines revenue recognition through the following steps:

- identification of the contract, or contracts, with a customer;
- identification of the performance obligations in the contract;

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RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

determination of the transaction price;
allocation of the transaction price to the performance obligations in the contract; and
recognition of revenue when, or as, the Company satisfies a performance obligation.

The Company recognizes revenues as follows:

Software subscriptions revenue

Software subscriptions revenue is generated from the sale of subscriptions to the Company's software applications and related services. These arrangements have contractual terms typically ranging from one month to five years, and include recurring fixed plan subscription fees and variable usage-based fees for usage in excess of plan limits.

Arrangements with customers do not provide the customer with the right to take possession of the Company's software at any time. Instead, customers are granted continuous access to the services over the contractual period. The Company transfers control evenly over the contractual period by providing stand-ready service. Accordingly, the fixed consideration related to subscription is generally recognized over time on a straight-line basis over the contract term beginning on the date the Company's service is made available to the customer. The Company may offer its customer services for no consideration during the initial months. Such discounts are recognized ratably over the term of the contract.

Fees for additional minutes of usage in excess of plan limits are deemed to be variable consideration that meet the allocation exception for variable consideration as they are specific to the month that the usage occurs.

The Company's subscription contracts typically allow the customers to terminate their services within the first 30 or 60 days and receive a refund for any amounts paid. After the termination period ends, the contract is non-cancellable and the customer is obligated to pay for the remaining term of the contract. Accordingly, the Company considers the non-cancellable term of the contract to begin after the expiration of the termination period.

The Company has service-level agreements with customers warranting defined levels of uptime reliability and performance and these customers can get credits or refunds if the Company fails to meet those levels. If the services do not meet certain criteria, fees are subject to adjustment or refund representing a form of variable consideration.

The Company records reductions to revenue for estimated sales returns and customer credits at the time the related revenue is recognized. Sales returns and customer credits are estimated based on the Company's historical experience, current trends and the Company's expectations regarding future experience. The Company monitors the accuracy of its sales reserve estimates by reviewing actual returns and credits and adjusts them for its future expectations to determine the adequacy of its current and future reserve needs. If actual future returns and credits differ from past experience, additional reserves may be required.

Other revenue

Other revenue is generated from product revenues from sales of phones and professional implementation services.

Product revenue is recognized when the products have been delivered to the customer. The amount of revenue recognized for products is adjusted for expected returns, which are estimated based on historical data.

The Company offers professional services that support implementation and deployment of its subscription services. Professional services do not result in significant customization of the product and are generally short-term in duration. The majority of our professional services contracts are on a fixed price basis and revenue is recognized over time as services are performed.

Deferred sales commission costs

The Company capitalizes sales commission expenses and associated payroll taxes paid to internal sales personnel and resellers, who sell our solutions. The resellers are selling agents for the Company and earn sales commissions which are directly tied to the value of the contracts that the Company enters with the end-user customers. These sales commissions are incremental costs the Company incurs to obtain contracts with its end-user customers. The Company pays sales commissions on initial contracts and contracts for increased purchases with existing customers (expansion contracts). The Company does not pay sales commissions for contract renewals.

RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

These sales commission costs are deferred and then amortized over the expected period of benefit, which is estimated to be five years. The Company has determined the period of benefit taking into consideration the expected subscription term and expected renewal periods of its customer contracts, the duration of its relationships with its customers considering historical and expected customer retention, technology and other factors. Amortization expense is included in sales and marketing expenses in the accompanying condensed consolidated statement of operations.

Disaggregation of revenue

The following table provides information about disaggregated revenue by primary geographical markets:

	Three Months Ended September 30, 2018		September 30, 2017		Nine Months Ended September 30, 2018		September 30, 2017	
Primary geographical markets								
North America	96.1	%	96.3	%	96.0	%	96.6	%
Others	3.9		3.7		4.0		3.4	
Total revenues	100.0	%	100.0	%	100.0	%	100.0	%

The Company derived approximately 88% of subscription revenues from RingCentral Office product for both the three and nine months ended September 30, 2018; and 84% for the three and nine months ended September 30, 2017.

Deferred revenue

During the three and nine months ended September 30, 2018, the Company recognized revenue of \$8.8 million and \$56.6 million, respectively, that was included in the corresponding deferred revenue balance at the beginning of the year.

Remaining performance obligations

The typical subscription term ranges from one month to five years. Contract revenue as of September 30, 2018 that has not yet been recognized was \$558.0 million. This excludes contracts with an original expected length of less than one year. The Company expects to recognize revenue of \$333.3 million over the next 12 months and \$224.7 million thereafter.

Share-Based Compensation

Share-based compensation expense resulting from options, restricted stock units ("RSUs"), performance-based awards, and employee stock purchase plan ("ESPP") rights granted is measured as the grant date fair value of the award and is recognized using the straight-line attribution method over the requisite service period of the award, which is generally the vesting period. The Company estimates the fair value of stock options, ESPP rights, and performance-based awards using the Black-Scholes-Merton option-pricing model. The Company estimates the fair value of RSUs as the closing market value of its Class A Common Stock on the grant date. For awards with performance-based and service-based conditions, compensation cost is recognized over the requisite service period if it is probable that the

performance condition will be satisfied. The expense for performance-based awards is evaluated each quarter based on the achievement of the performance conditions. The effect of a change in the estimated number of performance-based awards expected to be earned is recognized in the period those estimates are revised. Compensation expense for stock options and RSUs granted to non-employees is revalued, or marked to market, as of each reporting date until the stock options and RSUs are vested. Compensation expense is recognized net of estimated forfeiture activity, which is based on historical forfeiture rates.

Recent Accounting Pronouncements Not Yet Adopted

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which requires that lessees recognize a right-of-use asset and a lease liability on the balance sheet for all leases, with the exception of short-term leases. Both capital and operating leases will need to be recognized on the balance sheet. The standard is effective for interim and annual reporting periods beginning after December 15, 2018, with early adoption permitted. In 2018, the FASB issued ASU 2018-10 and 2018-11, providing, among other things, codification improvements and the optional transition method. The Company will adopt the standard in the first quarter of 2019, utilizing the optional transition method for adoption of Topic 842, which allows entities to continue to apply the legacy guidance in ASC 840, Leases, including disclosure requirements, in the comparative periods presented in the year of adoption. The Company is currently evaluating the impact that the standard will have on its consolidated financial statements and related disclosures

RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

and expects to take advantage of the transition package of practical expedients permitted within the new standard, which among other things, allows the Company to carryforward its historical lease classifications. The Company expects the impact of adoption of the new standard on the Company's consolidated statements of operations not to be material. The Company anticipates the most significant impact of adopting the new standard will primarily be the establishment of a right-of-use asset and a corresponding lease liability in its consolidated balance sheets.

In January 2017, the FASB issued ASU 2017-04, Simplifying the Test for Goodwill Impairment, which modifies the goodwill impairment test and requires an entity to write down the carrying value of goodwill up to the amount by which the carrying amount of a reporting unit exceeds its fair value. The standard is effective for interim and annual reporting periods beginning after December 15, 2019, with early adoption permitted. The adoption of this amendment is not expected to have a material impact on the Company's consolidated financial statements or disclosures.

In June 2018, the FASB issued ASU 2018-07, Compensation – Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting, which expands the scope of Topic 718 to include and simplify financial reporting for share-based payments issued to nonemployees. This amendment is applicable to all public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, with early adoption permitted. The Company is in the process of evaluating the impact of implementing this amendment on its financial statements or disclosures.

In July 2018, the FASB issued ASU 2018-09, Codification Improvements, which is intended to change or to clarify the codification or correct unintended application of guidance that is not expected to have a significant effect on current accounting practice or create a significant administrative cost to most entities. Since this applies to various codifications, its implementation and impact on financial statements would be commensurate with the codification itself, for example - it clarifies when companies should recognize excess tax benefits for share-based compensation awards; removes inconsistent guidance about income tax accounting for business combinations; clarifies derivatives measurement of a liability with an identical instrument held as an asset, and allows companies to use the portfolio approach to valuation of financial instruments; etc. The adoption of this amendment is not expected to have a material impact on the Company's consolidated financial statements or disclosures.

In June 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurements, which expands the disclosure requirements for Level 3 fair value measurements and expands disclosures for entities that calculate net assets value. This amendment is applicable to all public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, with early adoption permitted. The Company expects to adopt this update effective fiscal first quarter of 2020. The adoption of this amendment is not expected to have a material impact on the Company's consolidated financial statements or disclosures.

In June 2018, the FASB issued ASU 2018-15, Intangibles- Goodwill and Other – Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That is a Service Contract, which aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. This amendment is applicable to all public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, with early adoption permitted. The

Company is in the process of evaluating the impact of implementing this amendment on its financial statements or disclosures.

In August 2018, the SEC issued a final rule that amends certain disclosure requirements that were redundant, duplicative, overlapping or superseded. The final rule requires registrants, among other things, to disclose in interim periods changes to stockholders' equity for current and comparative year-to-date periods with subtotals for each interim period, and dividends per share for each class of shares. The final rule is effective for all filings made on or after November 5, 2018. On September 25, 2018, the SEC released guidance advising it will not object to a registrant adopting the requirement to include changes in stockholders' equity in the Form 10-Q for the first quarter beginning after the effective date of the rule. The Company expects to adopt the new rule in the first fiscal quarter of 2019. The adoption of this amendment is not expected to have a material impact on the Company's consolidated financial statements or disclosures.

RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 2. Impact of Recent Accounting Pronouncements

On January 1, 2018, the Company adopted Topic 606 utilizing the full retrospective method of transition. The Company adjusted its condensed consolidated financial statements from amounts previously reported due to the adoption of Topic 606.

Select condensed consolidated balance sheet line items, which reflect the adoption of the new ASU are as follows (in thousands):

	December 31, 2017		
	As Reported	Adoption of Topic 606	As Adjusted
Assets			
Accounts receivable, net	\$45,339	\$ 1,351	\$46,690
Deferred sales commission costs	—	15,424	15,424
Deferred sales commission costs, noncurrent	—	37,871	37,871
Liabilities			
Deferred revenue	64,415	(1,498)	62,917
Stockholders' equity	\$172,202	\$ 56,144	\$228,346

The following table reflects the effect of adoption of Topic 606 on the Company's condensed consolidated statement of operations for the three and nine months ended September 30, 2017 (in thousands):

	Three Months Ended September 30, 2017			Nine Months Ended September 30, 2017		
	As Reported	Adoption of Topic 606	As Adjusted	As Reported	Adoption of Topic 606	As Adjusted
Revenues						
Software subscriptions	\$ 119,401	\$ 515	\$ 119,916	\$333,501	\$ 1,441	\$334,942
Other	10,363	—	10,363	27,490	—	27,490
Total revenues	129,764	515	130,279	360,991	1,441	362,432
Gross profit	98,980	515	99,495	273,340	1,441	274,781
Operating expenses						
Sales and marketing	67,071	(5,466)	61,605	186,759	(14,528)	172,231
Operating loss	(6,246)	5,981	(265)	(21,090)	15,969	(5,121)
Net (loss) income	\$(5,712)	\$ 5,981	\$269	\$(20,052)	\$ 15,969	\$(4,083)
Basic net (loss) income per common share	\$(0.07)	\$ 0.07	\$0.00	\$(0.26)	\$ 0.21	\$(0.05)
Diluted net (loss) income per common share	\$(0.07)	\$ 0.07	\$0.00	\$(0.26)	\$ 0.21	\$(0.05)
Weighted-average number of shares used in computing net (loss) income per share						

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Basic	76,915	—	76,915	75,815	—	75,815
Diluted	76,915	6,194	83,109	75,815	—	75,815
13						

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Notes to Condensed Consolidated Financial Statements (Unaudited)

The following table reflects the effect of adoption of Topic 606 on the Company's condensed consolidated statement of cash flows for the nine months ended September 30, 2017 (in thousands):

	Nine Months Ended September 30, 2017		
	As Reported	Adoption of Topic 606	As Adjusted
Cash flows from operating activities			
Net loss	\$(20,052)	\$15,969	\$(4,083)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Amortization of deferred sales commission costs	—	8,874	8,874
Changes in operating assets and liabilities:			
Accounts receivable	(10,996)	(192)	(11,188)
Deferred sales commission costs	—	(23,402)	(23,402)
Deferred revenue	12,537	(1,249)	11,288
Net cash provided by operating activities	30,876	—	30,876

Note 3. Other Revenue and Cost of Revenue

Other revenues are primarily comprised of product revenue from the sale of pre-configured phones, phone rentals, and professional services. For the three and nine months ended September 30, 2018 and 2017, the majority of other revenues consisted of product revenues from sales of phones. Product revenues were \$9.0 million and \$6.9 million for the three months ended September 30, 2018 and 2017, respectively, and \$25.8 million and \$19.1 million for the nine months ended September 30, 2018 and 2017, respectively. Product cost of revenues were \$7.1 million and \$6.2 million for the three months ended September 30, 2018 and 2017, respectively, and \$22.5 million and \$18.2 million for the nine months ended September 30, 2018 and 2017, respectively.

Note 4. Financial Statement Components

Cash and cash equivalents consisted of the following (in thousands):

September 30,	December 31,
2018	2017

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Cash	\$ 62,009	\$ 70,893
Money market funds	515,274	110,299
Total cash and cash equivalents	\$ 577,283	\$ 181,192

The Company has an immaterial restricted cash balance as of September 30, 2018 and December 31, 2017, included in the cash balance above.

Accounts receivable, net consisted of the following (in thousands):

	September 30, 2018	December 31, 2017 *As Adjusted
Accounts receivable	\$ 65,885	\$ 42,243
Unbilled accounts receivable	10,456	5,159
Allowance for doubtful accounts	(2,158)	(712)
Accounts receivable, net	\$ 74,183	\$ 46,690

* See Note 2 for a summary of adjustments.

RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

Prepaid expenses and other current assets consisted of the following (in thousands):

	September 30, 2018	December 31, 2017
Prepaid expenses	\$ 18,113	\$ 13,690
Inventory	168	198
Other current assets	11,542	7,624
Total prepaid expenses and other current assets	\$ 29,823	\$ 21,512

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

	September 30, 2018	December 31, 2017
Computer hardware and software	\$ 93,223	\$ 74,555
Internal-use software development costs	26,406	18,217
Furniture and fixtures	5,586	6,293
Leasehold improvements	6,400	4,311
Total property and equipment	131,615	103,376
Less: accumulated depreciation and amortization	(71,415)	(60,078)
Property and equipment, net	\$ 60,200	\$ 43,298

Depreciation and amortization expense was \$4.8 million and \$13.9 million for the three and nine months ended September 30, 2018, respectively, and was \$4.0 million and \$11.3 million for the three and nine months ended September 30, 2017, respectively.

Accrued liabilities consisted of the following (in thousands):

	September 30, 2018	December 31, 2017
Accrued compensation and benefits	\$ 19,285	\$ 18,578
Accrued sales, use and telecom related taxes	16,961	11,828

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Accrued marketing	11,928	7,020
Other accrued expenses	37,540	17,551
Total accrued liabilities	\$ 85,714	\$ 54,977

The carrying values of intangible assets are as follows (in thousands):

		September 30, 2018			December 31, 2017		
		Estimated	Accumulated	Acquired	Cost	Accumulated	Acquired
	Lives	Cost	Amortization	Intangibles, Net		Amortization	Intangibles, Net
Customer relationships ⁽¹⁾	2 to 5 years	\$11,087	\$ 3,731	\$ 7,356	\$840	\$ 840	\$ -
Developed technology	5 years	3,010	2,000	1,010	3,010	1,548	1,462
Total acquired intangible assets		\$14,097	\$ 5,731	\$ 8,366	\$3,850	\$ 2,388	\$ 1,462

(1) Refer to Note 6 for details.

Amortization expense from acquired intangible assets for the three months ended September 30, 2018 and 2017 was \$1.0 million and \$0.2 million, respectively, and was \$3.3 million and \$0.6 million for the nine months ended September 30, 2018 and 2017, respectively.

RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

Amortization of developed technology is included in cost of revenues and amortization of customer relationships is included in sales and marketing expenses in the condensed consolidated statements of operations. At September 30, 2018, the weighted average amortization period for customer relationships and developed technology was approximately 3.6 years and 1.7 years, respectively.

Estimated amortization expense for acquired intangible assets for the following five fiscal years and thereafter is as follows (in thousands):

2018 (remaining)	\$579
2019	2,316
2020	1,972
2021	1,714
2022 onwards	1,785
Total estimated amortization expense	\$8,366

Deferred Sales Commission Costs

Deferred sales commission costs, which relate to sales commission costs capitalized for incremental cost of obtaining customer contracts, were \$71.1 million and \$53.3 million as of September 30, 2018 and December 31, 2017, respectively. Amortization expense for the deferred sales commission costs for the three months ended September 30, 2018 and 2017 were \$5.3 million and \$3.4 million, respectively, and was \$14.0 million and \$8.9 million for the nine months ended September 30, 2018 and 2017, respectively. There was no impairment loss in relation to the costs capitalized for the periods presented.

Note 5. Fair Value of Financial Instruments

The Company measures and reports certain cash equivalents, including money market funds and certificates of deposit, at fair value in accordance with the provisions of the authoritative accounting guidance that addresses fair value measurements. This guidance establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. The hierarchy is broken down into three levels based on the reliability of the inputs as follows:

Level 1: Observable inputs that reflect unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2: Other inputs, such as quoted prices for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

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Level 3: Unobservable inputs that are supported by little or no market activity and that are based on management's assumptions, including fair value measurements determined by using pricing models, discounted cash flow methodologies or similar techniques.

The financial assets carried at fair value were determined using the following inputs (in thousands):

	Balance at September 30, 2018	(Level 1)	(Level 2)	(Level 3)
Cash equivalents:				
Money market funds	\$ 515,274	\$515,274	\$ —	\$ —

	Balance at December 31, 2017	(Level 1)	(Level 2)	(Level 3)
Cash equivalents:				
Money market funds	\$ 110,299	\$110,299	\$ —	\$ —

The Company's other financial instruments, including accounts receivable, accounts payable, and other current liabilities, are carried at cost, which approximates fair value due to the relatively short maturity of those instruments.

RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

As of September 30,