PROOFPOINT INC
Form 10-Q
May 24, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended March 31, 2012
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 001-35506
PROOFPOINT, INC.
(Exact name of Registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	51-0414846 (I.R.S. employer identification no.)
892 Ross Drive Sunnyvale, California (Address of principal executive offices)	94089 (Zip Code)

(408) 517-4710

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 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 o NO þ

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 þ NO o

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

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

Shares of Proofpoint, Inc. common stock, $0.0001 par value per share, outstanding as of May 1, 2012: 31,052,396 shares.

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FORM 10-Q
Quarterly Period Ended March 31, 2012
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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

Proofpoint, Inc.
Condensed Consolidated Balance Sheets
(In thousands, except per share amounts)
(Unaudited)

	At March 31, 2012	At December 31, 2011
Assets		
Current assets		
Cash and cash equivalents	$12,575	$9,767
Short-term investments	616	2,947
Accounts receivable, net	14,334	15,789
Inventory	494	729
Deferred product costs, current	1,738	1,803
Prepaid expenses and other current assets	2,119	2,556
Total current assets	31,876	33,591
Property and equipment, net	6,760	7,353
Deferred product costs, noncurrent	644	987
Goodwill	18,557	18,557
Intangible assets, net	4,910	6,189
Other noncurrent assets	1,981	1,275
Total assets	$64,728	$67,952
Liabilities, Convertible Preferred Stock and Stockholders' Deficit		
Current liabilities		
Accounts payable	$3,638	$3,504
Accrued liabilities	9,153	10,061
Notes payable and lease obligations	830	467
Deferred rent	519	517
Deferred revenue	51,425	52,836
Total current liabilities	65,565	67,385
Notes payable and lease obligations, noncurrent	4,123	4,514
Other long term liabilities, noncurrent	93	85
Deferred revenue, noncurrent	24,078	23,404
Total liabilities	93,859	95,388
Convertible preferred stock, $0.0001 par value—39,424 shares authorized at December 31, 2011 and March 31, 2012; 38,942 shares issued and outstanding at December 31, 2011 and March 31, 2012, respectively, net of issuance costs (liquidation preference of $110,338 at December 31, 2011 and March 31, 2012, respectively)	109,911	109,911
Stockholders' deficit		
Common stock, $0.0001 par value—71,400 shares authorized at December 31, 2011 and March 31, 2012; 4,961 and 6,321 shares outstanding at December 31, 2011 and March 31, 2012, respectively	1	1
Additional paid-in capital	27,828	24,773
Accumulated other comprehensive loss	—	(3)

Accumulated deficit	(166,871)	(162,118)
Total stockholders' deficit	(139,042)	(137,347)
Total liabilities, convertible preferred stock, and stockholders' deficit	$64,728	$67,952

See accompanying Notes to the Condensed Consolidated Financial Statements.

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Proofpoint, Inc.
Condensed Consolidated Statements of Operations
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended March 31,	
	2012	2011
Revenue:		
Subscription	$23,269	$16,077
Hardware and services	1,350	2,704
Total revenue	24,619	18,781
Cost of revenue:(1)(2)		
Subscription	7,211	5,816
Hardware and services	1,169	1,583
Total cost of revenue	8,380	7,399
Gross profit	16,239	11,382
Operating expense:(1)(2)		
Research and development	5,881	4,941
Sales and marketing	12,175	9,445
General and administrative	2,766	2,048
Total operating expense	20,822	16,434
Operating loss	(4,583)	(5,052)
Interest expense, net	(60)	(76)
Other income (expense), net	(31)	149
Loss before provision for income taxes	(4,674)	(4,979)
Provision for income taxes	(79)	(106)
Net loss	$(4,753)	$(5,085)
Net loss per share, basic and diluted	$(0.85)	$(1.33)
Weighted average shares outstanding, basic and diluted	5,619	3,832
(1) Includes stock based compensation expense as follows:		
Cost of subscription revenue	$129	$98
Cost of hardware and services revenue	11	7
Research and development	422	278
Sales and marketing	651	429
General and administrative	288	245
(2) Includes intangible amortization expense as follows:		
Cost of subscription revenue	$1,153	$925
Research and development	8	—
Sales and marketing	118	343

See accompanying Notes to the Condensed Consolidated Financial Statements.

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Proofpoint, Inc.
Condensed Consolidated Statements of Comprehensive Income
(In thousands)
(Unaudited)

	Three Months Ended March 31,	
	2012	2011
Net loss	$(4,753)	$(5,085)
Other comprehensive income, before tax and net of reclassification adjustments:		
Unrealized gains on investments, net	—	3
Other comprehensive income, before tax	—	3
Tax benefit (provision) related to items of other comprehensive income	—	—
Other comprehensive income, net tax	—	3
Comprehensive loss	$(4,753)	$(5,082)

See accompanying Notes to the Condensed Consolidated Financial Statements.

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Proofpoint, Inc.
Condensed Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Three Months Ended March 31,	
	2012	2011
Cash flows from operating activities		
Net loss	$(4,753)	$(5,085)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities		
Depreciation and amortization	2,295	1,955
Stock based compensation	1,501	1,057
Change in fair value of contingent earn-outs	—	66
Changes in assets and liabilities:		
Accounts receivable	1,455	835
Inventory	235	122
Deferred products costs	408	833
Prepaid expenses and other current assets	437	347
Noncurrent assets	111	253
Accounts payable	714	(63)
Accrued liabilities	(1,432)	(1,106)
Deferred rent	2	(27)
Deferred revenue	(737)	371
Net cash provided by (used in) operating activities	236	(442)
Cash flows from investing activities		
Proceeds from sales and maturities of short-term investments	2,334	258
Purchase of property and equipment, net	(1,287)	(653)
Net cash provided by (used in) investing activities	1,047	(395)
Cash flows from financing activities		
Proceeds from issuance of common stock, net of repurchases	1,553	154
Repayments of equipment financing loans	(28)	(83)
Net cash provided by financing activities	1,525	71
Net increase (decrease) in cash and cash equivalents	2,808	(766)
Cash and cash equivalents		
Beginning of period	9,767	12,087
End of period	$12,575	$11,321

See accompanying Notes to the Condensed Consolidated Financial Statements.

Proofpoint, Inc.
Notes to Condensed Consolidated Financial Statements
(Unaudited)
(Dollars and share amounts in thousands, except per share amounts)

1. The Company and Summary of Significant Accounting Policies

The Company

Proofpoint, Inc. (the “Company”) was incorporated in Delaware in June 2002 and is headquartered in California. Proofpoint is a pioneering security-as-a-service vendor that enables large and mid-sized organizations worldwide to defend, protect, archive and govern their most sensitive data. The Company’s security-as-a-service platform is comprised of a number of data protection solutions, including threat protection, regulatory compliance, archiving and governance, and secure communication.

Reverse Stock Split

On March 30, 2012, the Company's Board of Directors approved a 1-for-2 reverse stock split of the Company's common stock. The reverse stock split became effective on April 2, 2012. Upon the effectiveness of the reverse stock split, (i) every two shares of outstanding common stock was decreased to one share of common stock, (ii) the number of shares of common stock into which each outstanding option to purchase common stock is exercisable was proportionally decreased on a 1-for-2 basis, (iii) the exercise price of each outstanding option to purchase common stock was proportionately increased on a 1-for-2 basis, and (iv) the conversion ratio for each share of preferred stock outstanding was proportionately reduced on a 1-for-2 basis. All of the share numbers, share prices, and exercise prices have been retrospectively adjusted to reflect the reverse stock split.

Basis of Presentation and Consolidation

The accompanying unaudited condensed consolidated financial statements and condensed footnotes have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments considered necessary for fair statement have been included. The results of operations for the three months ended March 31, 2012 are not necessarily indicative of the results to be expected for the year ended December 31, 2012 or for other interim periods or for future years.
The accompanying unaudited condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated on consolidation. The condensed consolidated balance sheet as of December 31, 2011 is derived from audited financial statements as of that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in our Prospectus dated April 19, 2012, filed with the SEC pursuant to Rule 424(b)(4) under the Securities Act of 1933 (the “Securities Act”), as amended.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of expenses during the reporting period. Actual results could differ from those estimates and such difference may be material to the financial statements.

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Foreign Currency Remeasurement and Transactions

The Company's sales to international customers are generally U.S. dollar denominated. As a result, there are no significant foreign currency gains or losses related to these transactions. The functional currency for the Company's wholly-owned foreign subsidiaries is the U.S. dollar. Accordingly, the subsidiaries remeasure monetary assets and liabilities at period-end exchange rates, while nonmonetary items are remeasured at historical rates. Income and expense accounts are remeasured at the average exchange rates in effect during the year. Remeasurement adjustments are recognized in the consolidated statement of operations as transaction gains or losses within other income (expense), net, in the period of occurrence. Aggregate transaction gains (losses) included in determining net loss were $94 and ($30) for the three months ended March 31, 2011 and 2012, respectively.

Cash, Cash Equivalents and Short Term Investments

The Company considers all highly liquid instruments purchased with an original maturity date of 90 days or less from the date of purchase to be cash equivalents. Cash equivalents consist of money market funds. Cash equivalents were $9,767 and $12,575 as of December 31, 2011 and March 31, 2012, respectively. Short-term investments consist of readily marketable securities with remaining maturity of more than three months from the date of purchase and include commercial paper, corporate bonds, and debt securities. Short-term investments were $2,947 and $616 as of December 31, 2011 and March 31, 2012, respectively, and all were classified as available-for-sale and were carried at fair value, with unrealized gains and losses reported as a component of accumulated other comprehensive loss. Realized gains and losses are included in "other income (expense), net." Fair value is estimated based on available market information. The cost of securities sold is based on the specific identification method.

Revenue Recognition

The Company derives its revenue primarily from two sources: (1) subscription revenue for rights related to the use of the security-as-a-service platform and (2) hardware, training and professional services revenue provided to customers related to their use of the platform. Subscription revenue is derived from a subscription based enterprise licensing model with contract terms typically ranging from one to three years, and consist of (i) subscription fees from the licensing of the security-as-a-service platform, (ii) subscription fees for access to the on-demand elements of the platform and (iii) subscription fees for the right to access the Company's customer support services.

The Company applies the provision of ASC 985-605, "Software Revenue Recognition," and related interpretations, to all transactions involving the licensing of software, as well as related support, training, and other professional services. ASC 985-605 requires revenue earned on software arrangements involving multiple elements such as software license, support, training and other professional services to be allocated to each element based on the relative fair values of these elements. The fair value of an element must be based on vendor specific objective evidence ("VSOE") of fair value. VSOE of fair value of each element is based on the price charged when the element is sold separately. Revenue is recognized when all of the following criteria are met as set forth in ASC 985-605:

- Persuasive evidence of an arrangement exists,
- Delivery has occurred,
- The fee is fixed or determinable, and
- Collectability is probable.

The Company has analyzed all of the elements included in its multiple element arrangements and has determined that it does not have sufficient VSOE of fair value to allocate revenue to its subscription and software license agreements, support, training, and professional services. The Company defers all revenue under the software arrangement until the commencement of the subscription services and any associated professional services. Once the subscription services and the associated professional services have commenced, the entire fee from the arrangement is recognized ratably over the remaining period of the arrangement. If the professional services are essential to the functionality of the subscription, then the revenue recognition does not commence until such services are completed.

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In the consolidated statement of operations, revenue is categorized as "subscription" and "hardware and services." Although the Company is unable to separate its multiple elements under the applicable revenue recognition guidance since it does not have sufficient VSOE of fair value for revenue recognition purposes, the Company has used a systematic and rational estimate to classify revenue between "subscription" and "hardware and services." For presentation purposes only, the Company allocates revenue to hardware and services based upon management's best estimate of fair value of such deliverables using a cost plus model. The remaining consideration of the arrangement is then allocated to subscription services. Management believes that this methodology provides a reasonable basis to allocate revenue between subscription and hardware and services for presentation purposes.

The hosted on-demand service agreements do not provide customers with the right to take possession of the software supporting the hosted service. The Company recognizes revenue from its hosted on-demand services in accordance with ASC 605-20, and as such recognizes revenue when the following criteria are met:

- Persuasive evidence of an arrangement exists,
- Delivery of the Company’s obligations to its customers has occurred,
- Collection of the fees is probable, and
- The amount of fees to be paid by the customer is fixed or determinable.

In October 2009, the FASB amended the accounting guidance for multiple element arrangements (“ASU 2009-13”) to:

- Provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and how the arrangement consideration should be allocated among its elements;
- Require an entity to allocate revenue in an arrangement that has separate units of accounting using best estimated selling price (“BESP”) of deliverables if a vendor does not have VSOE of fair value or third-party evidence of selling price (“TPE”), and
- Eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method to the separate unit of accounting.

Concurrently, the FASB amended the accounting guidance for revenue recognition (“ASU 2009-14”) to exclude hardware appliances containing software components and hardware components that function together to deliver the hardware appliance’s essential functionality from the scope of the software revenue recognition guidance of ASC 985-605.

The Company elected to adopt this new guidance in the first quarter of fiscal 2011 for new and materially modified revenue arrangements originating after January 1, 2011.

Prior to the adoption of ASU 2009-14, revenue derived from hardware appliance sales were recognized based on the software revenue recognition guidance. The Company could not establish VSOE of fair value for the undelivered elements in the arrangement, and therefore the entire fee from the arrangement was recognized ratably over the contractual term of the agreement. In addition, the Company was unable to establish VSOE of fair value of its hosted on-demand service agreements, and therefore the entire fee for the agreement was recognized ratably over the contractual term of the agreement.

As a result of the adoption of this accounting guidance, revenue derived from our subscription services and hardware appliance sales are no longer subject to industry specific software revenue recognition guidance. For all arrangements within the scope of these new accounting pronouncements, including the Company’s hosted on-demand services, the Company evaluates each element in a multiple element arrangement to determine whether it represents a separate unit of accounting. An element constitutes a separate unit of accounting when the delivered item has standalone value and delivery of the undelivered element is probable and within the Company’s control. Revenue derived from the licensing of the security-as-a-service platform continues to be accounted for in accordance with the industry specific revenue recognition guidance.

Hardware appliance revenue is recognized upon shipment. Subscription and support revenue are recognized over the contract period commencing on the start date of the contract. Professional services and training, when sold with hardware appliances or subscription and support services, are accounted for separately when those services have standalone value. In

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determining whether professional services and training services can be accounted for separately from subscription and support services, the Company considers the following factors: availability of the services from other vendors, the nature of the services, and the dependence of the subscription services on the customer's decision to buy the professional services. If professional services and training do not qualify for separate accounting, the Company recognizes the professional services and training ratably over the contract term of the subscription services.

Delivery generally occurs when the hardware appliance is delivered to a common carrier freight on board shipping point by the Company or the hosted service has been activated and communicated to the customer accordingly. The Company's fees are typically considered to be fixed or determinable at the inception of an arrangement and are negotiated at the outset of an arrangement, generally based on specific products and quantities to be delivered. In the event payment terms are provided that differ significantly from its standard business practices, the fees are deemed to not be fixed or determinable and revenue is recognized as the fees become paid.

The Company assesses collectability based on a number of factors, including credit worthiness of the customer and past transaction history of the customer. Through December 31, 2011, the Company has not experienced significant credit losses.

Revenue as reported and pro forma revenue that would have been reported during the three months ended March 31, 2012, had the Company not adopted the new guidance is shown in the following table (in thousands):

	As Reported	Pro Forma Basis (as if previous guidance was in effect)
Total revenue	$24,619	$23,933

Deferred Revenue

Deferred revenue primarily consists of billings or payments received in advance of revenue recognition from the sale of the Company's subscription fees, and training and professional services. Once the revenue recognition criteria are met, this revenue is recognized ratably over the term of the associated contract, which typically ranges from 12 to 36 months.

Fair Value of Financial Instruments

The carrying amounts of certain of the Company's cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate their fair values due to their short maturities. Based on borrowing rates that are available to the Company for loans with similar terms and consideration of the Company's credit risk, the carrying value of the note payable approximates its fair value. The carrying value of the preferred stock warrant liability represents its fair value. See Note 6, "Financial Instruments and Fair Value Measurements," regarding the fair values of the Company's investments and preferred stock warrant liability.

Comprehensive Income (Loss)

Comprehensive income (loss) includes all changes in equity that are not the result of transactions with stockholders. The Company's comprehensive income (loss) consists of its net loss and changes in unrealized gains (losses) from its available-for-sale investments. For the Company's first reporting period beginning after December 15, 2011, the Company adopted guidance issued by FASB amending the presentation of the Statement of Comprehensive Income. The amended guidance eliminates the current option to report other comprehensive income and its components of other comprehensive income as part of the statement of changes in stockholders' equity. In addition, it gives an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The Company has implemented this guidance for the quarter ended March 31, 2012.

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Recent Accounting Pronouncements

In September 2011, the Financial Accounting Standards Board (the "FASB") issued amended guidance relating to the goodwill impairment test. The guidance allows an entity an option to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under that option, an entity no longer would be required to calculate the fair value of a reporting unit unless the entity determines, based on that qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. The guidance also includes examples of the types of events and circumstances to consider in conducting the qualitative assessment. The guidance will be effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted. The Company is currently evaluating the impact of this amended guidance on its consolidated financial statements.

2. Goodwill and Intangible Assets

Goodwill represents the excess of the purchase price of the acquired enterprise over the fair value of identifiable assets acquired and liabilities assumed. The Company applies ASC 350, "Intangibles—Goodwill and Other," and performs an annual goodwill impairment test during the fourth quarter of the Company's fiscal year and more frequently if an event or circumstance indicates that an impairment may have occurred. For the purposes of impairment testing, the Company has determined that it has one reporting unit. A two-step impairment test of goodwill is required pursuant to ASC 350-20-35. In the first step, the fair value of the reporting unit is compared to its carrying value. If the fair value exceeds the carrying value, goodwill is not impaired and further testing is not required. If the carrying value exceeds the fair value, then the second step of the impairment test is required to determine the implied fair value of the reporting unit's goodwill. The implied fair value of goodwill is calculated by deducting the fair value of all tangible and intangible net assets of the reporting unit, excluding goodwill, from the fair value of the reporting unit as determined in the first step. If the carrying value of the reporting unit's goodwill exceeds its implied fair value, then an impairment loss must be recorded that is equal to the difference. The identification and measurement of goodwill impairment involves the estimation of the fair value of the Company. The estimate of fair value of the Company, based on the best information available as of the date of the assessment, is subjective and requires judgment, including management assumptions about expected future revenue forecasts and discount rates. No impairment to the carrying value of goodwill was identified by the Company during the year ended December 31, 2011 and the three months ended March 31, 2012.

Intangible assets consist of developed technology, vendor relationships and customer relationships. The values assigned to intangibles are based on estimates and judgments regarding expectations for success and life cycle of solutions and technologies acquired.

Intangible assets are amortized on a straight-line basis over their estimated lives, which approximate the pattern in which the economic benefits of the intangible assets are consumed, as follows:

Developed technology	4 years
Customer relationships	4 years
Vendor relationships	4 years

The goodwill activity and balances are presented below:

	December 31, 2011	March 31, 2012
Opening balance	$15,932	$18,557
Add: Goodwill from acquisitions	2,625	—
Closing balance	$18,557	$18,557

The goodwill balance as of December 31, 2011 and March 31, 2012 was the result of the acquisitions of Fortiva, Inc., Secure Data in Motion, Inc ("Sigaba"), Everyone.net, Inc. ("EDN"), GFI Software Ltd., (Spam and Open Relay Blocking

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System or “SORBS”) and NextPage, Inc..

Intangible Assets

Intangible assets excluding goodwill, consisted of the following:

	December 31, 2011			March 31, 2012		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	$17,641	$(12,378)	$5,263	$17,641	$(13,478)	$4,163
Customer relationships	2,408	(1,685)	723	2,408	(1,836)	572
Vendor relationships	290	(290)	—	—	—	—
Non compete	106	(1)	105	106	(7)	99
Trademark and patents	98	—	98	98	(22)	76
	$20,543	$(14,354)	$6,189	$20,253	$(15,343)	$4,910

In the quarter ended March 31, 2011, the Company revised the useful life of the vendor relationship intangible asset. The Company fully depreciated this intangible asset given that it is no longer using the technology provided by this vender. Accordingly, the entire remaining balance of $0.3 million was expensed.

Amortization expense of intangibles totaled $1,268 and $1,279 during the three months years ended March 31, 2011 and 2012, respectively.

Future estimated amortization costs of intangible assets as of March 31, 2012 are presented below:

Remainder of 2012	$1,997
2013	1,479
2014	725
2015	709
	$4,910

3. Financial Instruments and Fair Value Measurements

The cost and fair value of the Company’s available-for-sale investments as of December 31, 2011 and March 31, 2012 were as follows:

	December 31, 2011			
	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
Money market funds	$6,850	$—	$—	$6,850
Corporate debt securities	2,950	—	(3)	2,947
	$9,800	$—	$(3)	$9,797
Amount classified as cash and cash equivalents				$6,850
Amount classified as short-term investments				2,947
				$9,797

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	March 31, 2012			
	Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value
Money market funds	$12,575	$—	$—	$12,575
Corporate debt securities	616	—	—	616
	$13,191	$—	$—	$13,191
Amount classified as cash and cash equivalents				$12,575
Amount classified as short-term investments				616
				$13,191

As of December 31, 2011 and March 31, 2012, all investments mature in less than one year. Estimated fair values for marketable securities are based on quoted market prices for the same or similar instruments.

Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., the “exit price”) in an orderly transaction between market participants at the measurement date. A hierarchy for inputs used in measuring fair value has been defined to minimize the use of unobservable inputs by requiring the use of observable market data when available. Observable inputs are inputs that market participants would use in pricing the asset or liability based on active market data. Unobservable inputs are inputs that reflect the Company’s assumptions about the assumptions market participants would use in pricing the asset or liability based on the best information available in the circumstances.

The fair value hierarchy prioritizes the inputs into three broad levels:

- Level 1 Quoted (unadjusted) prices in active markets for identical assets or liabilities.

The Company’s Level 1 assets consist of money market funds, and a certificate of deposit.

- Level 2 Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities 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 asset or liability.

The Company’s Level 2 assets and liabilities consist of corporate bonds and agency debt securities.

- Level 3 Unobservable inputs to the valuation methodology that are supported by little or no market activity and that are significant to the measurement of the fair value of the assets or liabilities. Level 3 assets and liabilities include those whose fair value measurements are determined using pricing models, discounted cash flow methodologies or similar valuation techniques, as well as significant management judgment or estimation.

The Company’s Level 3 liabilities consist of the Series B preferred stock warrants, which were exercised during the year ended December 31, 2011.

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The following tables summarize, for each category of assets or liabilities, the respective fair value as of December 31, 2011 and March 31, 2012 and the classification by level of input within the fair value hierarchy.

	Balance as of December 31, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
Cash equivalents:				
Money market funds	$6,850	$6,850	$—	$—
Short-term investments:				
Corporate debt securities	2,947	—	2,947	—
	$9,797	$6,850	$2,947	$—

	Balance as of March 31, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
Cash equivalents:				
Money market funds	$12,575	$12,575	$—	$—
Short-term investments:				
Corporate debt securities	616	—	616	—
	$13,191	$12,575	$616	$—

The following table is a reconciliation of the preferred stock warrant liability that is measured at fair value using significant unobservable inputs (Level 3):

Balance at December 31, 2010	$157	
Change in fair value recorded in other income (expense), net	(66	)
Preferred warrant conversion	(91	)
Balance at December 31, 2011	$—	

In measuring fair value where Level 3 inputs were used, the Company measured the fair value of the preferred stock warrants liability using the Black Scholes option pricing model. See Note 9, "Preferred Stock."

4. Commitments and Contingencies

Operating Leases

The Company leases certain of its facilities under noncancelable operating leases with various expiration dates through June 2014.

Rent expense was $322 and $390 for the three months ended March 31, 2011 and 2012, respectively.

Capital Leases

The Company acquired capital leases as part of the EDN acquisition. The leases were secured by fixed assets primarily used in a data center. The leases have various expiration dates through October 2012. The interest rates range from 2.9% to 10.6%.

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At March 31, 2012, future annual minimum lease payments under noncancelable operating and capital leases were as follows:

	Capital Leases	Operating Leases
2012 remainder	$36	$4,248
2013	—	3,288
2014	—	982
2015	—	6
Total minimum lease payments	36	8,524
Less: Amount representing interest	(8)	
Present value of capital lease obligations	28	
Less: Current portion	(28)	
Long-term portion of capital lease obligations	$—	

Contingencies

Under the indemnification provisions of the Company's customer agreements, the Company agrees to indemnify and defend and hold harmless its customers against, among other things, infringement of any patent, trademark or copyright under any country's laws or the misappropriation of any trade secret arising from the customers' legal use of the Company's solutions. The exposure to the Company under these indemnification provisions is generally limited to the total amount paid by the customers under the applicable customer agreement. However, certain indemnification provisions potentially expose the Company to losses in excess of the aggregate amount paid to the Company by the customer under the applicable customer agreement. To date, there have been no claims against the Company or its customers pursuant to these indemnification provisions.

Legal Contingencies

From time to time, the Company is involved in claims and legal proceedings that arise in the ordinary course of business. Based on currently available information, management does not believe that the ultimate outcome of these unresolved matters, individually and in the aggregate, is likely to have a material adverse effect on the Company's financial position, results of operations or cash flows. However, litigation is subject to inherent uncertainties and the Company's view of these matters may change in the future. Were an unfavorable outcome to occur, there exists the possibility of a material adverse impact on the Company's financial position, results of operations or cash flows for the period in which the unfavorable outcome occurs, and potentially in future periods.

The Company determined that subsequent to its acquisition of Fortiva, Inc., a Canadian company, (see Note 2) in August 2008, it shipped a particular hardware appliance model to a limited number of international customers that, prior to shipment, required either a one-time product review or application for an encryption registration number in lieu of such product review. The Company has made voluntary submissions to the United States Commerce Department's Bureau of Industry and Security (BIS) to report this potential violation. Based upon the results of the internal investigation completed to date, the Company does not believe that the amount of any loss incurred as a result of this matter would be material to its business, financial condition, results of operations or cash flows.

As part of a pre-IPO due diligence review, the Company discovered a potential export violation involving the provision of web-based, email communication services through its Everyone.net service, which the Company acquired in October 2009 (see Note 2). The Company's records indicate that there were two end-users who may have, for a portion of their respective service periods, been located in Iran, a United States designated state sponsor of terrorism. The Company's internal investigation has progressed and the Company has found that the issues identified are specific to the acquired Everyone.net system, which has a separate customer database and billing system from that of Proofpoint's main businesses. The Company does not have any indication that these services were utilized by the Iranian government. The accounts of both end-users were terminated in 2010 and accounted for approximately $15 in payments to us in 2009 and $6 in payments to us in 2010. Although the Company has ceased providing the service, the Company has made voluntary submissions to the U.S. Department of Treasury's Office of Foreign Assets Control, or OFAC, to report this potential violation. Based upon the results of the internal investigation completed to date, the Company does not believe that the amount of any loss incurred as a result of this matter

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would be material to its business, financial condition, results of operations or cash flows.

5. Debt

Equipment Financing Loans

The Company entered into a new equipment loan agreement with Silicon Valley Bank in April 2011 for an aggregate loan principal amount of $6,000. Interest on the advances are equal to prime rate plus 0.50%. As of March 31, 2012, the interest on the advances was 4.50%. The Company has the ability to draw down on this equipment line through April 19, 2012. Each drawn amount is due 48 months after funding. Borrowings outstanding under the equipment loan at March 31, 2012 were $4,925. Equipment financed under this loan arrangement is collateralized by the respective assets underlying the loan. The terms of the loan restrict the Company's ability to pay dividends. The loan includes a covenant that requires the Company to maintain cash and cash equivalents plus net accounts receivable of at least two times the amount of all outstanding indebtedness. As of March 31, 2012, the Company was in compliance with the financial covenant.

The Company had a previous equipment loan arrangement with Silicon Valley Bank for $2,000. The loan bore interest at an annual rate of 8.75%. The maturity date was 36 months after the funding date. Borrowings outstanding under the equipment loan at March 31, 2011 were $0.2 million and $0 at December 31, 2011, as the loan was completely repaid and closed in June 2011. Equipment financed under this loan arrangement was collateralized by the respective assets underlying each specific draw down. This loan required the Company to maintain a tangible net worth greater than $18,000 and during the term of the loan, the Company was in compliance with the financial covenant.

Interest expense for the three months ended March 31, 2011 and 2012 was approximately $1 and $52, respectively.

At March 31, 2012, the repayment commitments related to the equipment loans are as follows:

2012 remainder	$411
2013	1,587