

Five9, Inc.  
Form 10-Q  
May 13, 2015  
Table of Contents

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2015

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: 001-36383

Five9, Inc.  
(Exact Name of Registrant as Specified in Its Charter)

Delaware  
(State or Other Jurisdiction of  
Incorporation or Organization)  
Bishop Ranch 8  
4000 Executive Parkway, Suite 400  
San Ramon, CA 94583  
(Address of Principal Executive Offices) (Zip Code)  
(925) 201-2000  
(Registrant’s Telephone Number, Including Area Code)

94- 3394123  
(I.R.S. Employer  
Identification No.)

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

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

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

Large Accelerated Filer  Accelerated Filer

Non-accelerated filer  (Do not check if a smaller reporting Company) Smaller Reporting Company

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 April 30, 2015, there were 49,837,098 shares of the Registrant’s common stock, par value \$0.001 per share, outstanding.



Table of Contents

FIVE9, INC.

FORM 10-Q

TABLE OF CONTENTS

<u>SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS</u>	<u>3</u>
<u>PART I. FINANCIAL INFORMATION</u>	<u>4</u>
<u>ITEM 1. Financial Statements</u>	<u>4</u>
<u>Condensed Consolidated Balance Sheets (Unaudited)</u>	<u>4</u>
<u>Condensed Consolidated Statements of Operations and Comprehensive Loss (Unaudited)</u>	<u>5</u>
<u>Condensed Consolidated Statements of Cash Flows (Unaudited)</u>	<u>6</u>
<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	<u>7</u>
<u>ITEM 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>19</u>
<u>Overview</u>	<u>19</u>
<u>Key Operating and Financial Performance Metrics</u>	<u>20</u>
<u>Key Components of Our Results of Operations</u>	<u>22</u>
<u>Results of Operations for the Three Months Ended March 31, 2015 and 2014</u>	<u>24</u>
<u>Liquidity and Capital Resources</u>	<u>26</u>
<u>Critical Accounting Policies and Estimates</u>	<u>28</u>
<u>Off Balance Sheet Arrangements</u>	<u>29</u>
<u>Contractual Obligations</u>	<u>29</u>
<u>ITEM 3. Quantitative and Qualitative Disclosure about Market Risk</u>	<u>29</u>
<u>ITEM 4. Controls and Procedures</u>	<u>30</u>
<u>PART II. OTHER INFORMATION</u>	<u>31</u>
<u>ITEM 1. Legal Proceedings</u>	<u>31</u>
<u>ITEM 1A. Risk Factors</u>	<u>32</u>
<u>ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>55</u>
<u>ITEM 3. Defaults Upon Senior Securities</u>	<u>55</u>
<u>ITEM 4. Mine Safety Disclosures</u>	<u>55</u>
<u>ITEM 5. Other Information</u>	<u>55</u>
<u>ITEM 6. Exhibits</u>	<u>56</u>
<u>SIGNATURES</u>	<u>57</u>

Table of Contents

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which involve substantial risks and uncertainties. These statements reflect the current views of our senior management with respect to future events and our financial performance. These forward-looking statements include statements with respect to our business, expenses, strategies, losses, growth plans, product and customer initiatives, market growth projections, and our industry. Statements that include the words “expect,” “intend,” “plan,” “believe,” “project,” “forecast,” “estimate,” “may,” “should,” “anticipate” and similar statements of a future or forward-looking nature identify forward-looking statements for purposes of the federal securities laws or otherwise.

Forward-looking statements address matters that involve risks and uncertainties. Accordingly, there are or will be important factors that could cause our actual results to differ materially from those indicated in these statements. These factors include the information set forth under the caption “Risk Factors” and elsewhere in this report, including the following:

- our quarterly and annual results may fluctuate significantly, may not fully reflect the underlying performance of our business and may result in decreases in the price of our common stock;
- if we are unable to attract new clients or sell additional services and functionality to our existing clients, our revenue and revenue growth will be harmed;
- our recent rapid growth may not be indicative of our future growth, and even if we continue to grow rapidly, we may fail to manage our growth effectively;
- the markets in which we participate are highly competitive, and if we do not compete effectively, our operating results could be harmed;
- if we fail to manage our technical operations infrastructure, our existing clients may experience service outages, our new clients may experience delays in the deployment of our solution and we could be subject to, among other things, claims for credits or damages;
- if our existing clients terminate their subscriptions or reduce their subscriptions and related usage, our revenues and gross margins will be harmed and we will be required to spend more money to grow our client base;
- we sell our solution to larger organizations that require longer sales and implementation cycles and often demand more configuration and integration services or customized features and functions that we may not offer, any of which could delay or prevent these sales and harm our growth rates, business and operating results;
- because a significant percentage of our revenue is derived from existing clients, downturns or upturns in new sales will not be immediately reflected in our operating results and may be difficult to discern;
- we rely on third-party telecommunications and internet service providers to provide our clients and their customers with telecommunication services and connectivity to our cloud contact center software and any failure by these service providers to provide reliable services could subject us to, among other things, claims for credits or damages;
- we have a history of losses and we may be unable to achieve or sustain profitability;
- we may not be able to secure additional financing on favorable terms, or at all, to meet our future capital needs; and
- failure to comply with laws and regulations could harm our business and our reputation.

The foregoing factors should not be construed as exhaustive and should be read together with the other cautionary statements included in this report. If one or more of these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, our actual results may differ materially from what we anticipate. You should not place undue reliance on our forward-looking statements. Any forward-looking statements you read in this report reflect our views as of the date of this report with respect to future events and are subject to these and other risks, uncertainties and assumptions relating to our operations, results of operations, growth strategy and liquidity. We undertake no obligation to update any forward-looking statements made in this report to reflect events or circumstances after the date of this report or to reflect new information or the occurrence of unanticipated events, except as required by law.



Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. Financial Statements

## FIVE9, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited, in thousands, except per share data)

	March 31, 2015	December 31, 2014
<b>ASSETS</b>		
Current assets:		
Cash	\$50,646	\$58,289
Short-term investments	19,999	20,000
Accounts receivable, net	8,719	8,335
Prepaid expenses and other current assets	3,170	1,960
Total current assets	82,534	88,584
Property and equipment, net	12,426	12,571
Intangible assets, net	2,425	2,553
Goodwill	11,798	11,798
Other assets	863	1,428
Total assets	\$110,046	\$116,934
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$2,541	\$4,179
Accrued and other current liabilities	8,107	7,318
Accrued federal fees	7,531	7,215
Sales tax liability	1,221	297
Notes payable	3,528	3,146
Capital leases	4,467	4,849
Deferred revenue	5,641	5,346
Total current liabilities	33,036	32,350
Revolving line of credit	12,500	12,500
Sales tax liability — less current portion	2,303	2,582
Notes payable — less current portion	21,698	22,778
Capital leases — less current portion	4,560	4,423
Other long-term liabilities	748	548
Total liabilities	74,845	75,181
Commitments and contingencies (Note 10)		
Stockholders' equity:		
Preferred stock, \$0.001 par value; 5,000 shares authorized, no shares issued and outstanding at March 31, 2015 and December 31, 2014	—	—
Common stock, \$0.001 par value; 450,000 shares authorized, 49,612 shares and 49,322 shares issued and outstanding at March 31, 2015 and December 31, 2014, respectively	50	49
Additional paid-in capital	172,637	170,286
Accumulated other comprehensive loss	(1	) —
Accumulated deficit	(137,485	) (128,582
Total stockholders' equity	35,201	41,753
Total liabilities and stockholders' equity	\$110,046	\$116,934
See accompanying notes to condensed consolidated financial statements.		



Table of Contents

FIVE9, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(Unaudited, in thousands, except per share data)

	Three Months Ended	
	March 31, 2015	March 31, 2014
Revenue	\$30,274	\$24,274
Cost of revenue	14,778	13,148
Gross profit	15,496	11,126
Operating expenses:		
Research and development	6,038	5,225
Sales and marketing	9,931	9,022
General and administrative	7,275	6,171
Total operating expenses	23,244	20,418
Loss from operations	(7,748)	(9,292)
Other income (expense), net:		
Change in fair value of convertible preferred and common stock warrant liabilities	—	1,745
Interest expense	(1,139)	(778)
Interest income and other	2	32
Total other income (expense), net	(1,137)	999
Loss before provision for income taxes	(8,885)	(8,293)
Provision for income taxes	18	27
Net loss	\$(8,903)	\$(8,320)
Net loss per share:		
Basic and diluted	\$(0.18)	\$(1.48)
Shares used in computing net loss per share:		
Basic and diluted	49,433	5,608
Comprehensive Loss:		
Net loss	\$(8,903)	\$(8,320)
Other comprehensive loss:		
Change in unrealized gain/loss on short-term investments, net of tax	(1)	—
Comprehensive loss	\$(8,904)	\$(8,320)
See accompanying notes to condensed consolidated financial statements.		



Table of Contents

FIVE9, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in thousands)

	Three Months Ended	
	March 31, 2015	March 31, 2014
Cash flows from operating activities:		
Net loss	\$(8,903)	\$(8,320)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,775	1,592
Provision for doubtful accounts	113	20
Stock-based compensation	2,235	1,196
Loss on the disposal of property and equipment	10	—
Non-cash interest expense	84	51
Changes in fair value of convertible preferred and common stock warrant liabilities	—	(1,745)
Others	(1)	—
Changes in operating assets and liabilities:		
Accounts receivable	(510)	344
Prepaid expenses and other current assets	(1,211)	(965)
Other assets	(94)	(65)
Accounts payable	(1,629)	(221)
Accrued and other current liabilities	1,123	875
Accrued federal fees and sales tax liability	960	523
Deferred revenue	286	582
Other liabilities	9	(47)
Net cash used in operating activities	(5,753)	(6,180)
Cash flows from investing activities:		
Purchases of property and equipment	(198)	(71)
Decrease (increase) in restricted cash	660	(25)
Purchase of short-term investments	(20,000)	—
Proceeds from maturity of short-term investments	20,000	—
Net cash provided by (used in) investing activities	462	(96)
Cash flows from financing activities:		
Payments for deferred offering costs	—	(805)
Proceeds from exercise of common stock options and warrants	116	556
Proceeds from notes payable	—	19,561
Repayments of notes payable	(781)	(264)
Payments of capital leases	(1,687)	(1,282)
Net cash provided by (used in) financing activities	(2,352)	17,766
Net increase (decrease) in cash and cash equivalents	(7,643)	11,490
Cash and cash equivalents:		
Beginning of period	58,289	17,748
End of period	\$50,646	\$29,238
Non-cash investing and financing activities:		
Equipment obtained under capital lease	\$1,309	\$769
Equipment purchased and unpaid at period-end	16	20
Deferred initial public offering costs incurred but unpaid at period-end	—	1,787
	—	509

Net cashless exercise of preferred stock warrants to Series A-2 convertible preferred stock		
Vesting of early exercised stock options	—	28
See accompanying notes to the condensed consolidated financial statements.		

Table of Contents

FIVE9, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

1. Description of Business and Summary of Significant Accounting Policies

Five9, Inc. (together with its wholly-owned subsidiaries, the “Company”) is a provider of cloud contact center software. The Company was incorporated in Delaware in 2001 and is headquartered in San Ramon, California. The Company has offices in Europe and Asia, which primarily provide research, development and client support services.

Basis of Presentation

The accompanying 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 financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Therefore, these condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014. All intercompany transactions and balances have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements in accordance 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 consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. The significant estimates made by management affect revenue, the allowance for doubtful accounts, intangible assets, including goodwill, loss contingencies, including the Company’s accrual for federal fees and sales tax liability, accrued liabilities, stock-based compensation, fair value calculations of the convertible preferred and common stock warrant liabilities, provision for income taxes and uncertain tax positions. Management periodically evaluates such estimates and they are adjusted prospectively based upon such periodic evaluation. Actual results could differ from those estimates.

Significant Accounting Policies

The Company’s significant accounting policies are disclosed in its Annual Report on Form 10-K for the year ended December 31, 2014. During the three months ended March 31, 2015, there were no changes to our significant accounting policies.

Recent Accounting Pronouncements

In April 2015, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2015-05, Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement. The ASU provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The ASU does not change the accounting for a customer’s accounting for service contracts. A company can elect to adopt the ASU either prospectively or retrospectively. This guidance is effective for the Company beginning in the first quarter of 2016. Early adoption is permitted. The Company does not expect this guidance to have a material effect on its consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. The ASU requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by this ASU. Early adoption is permitted. This guidance is effective for the Company on a retrospective basis beginning in the first quarter of 2016 and is not expected to have a material effect on the Company’s consolidated financial statements.



Table of Contents

In August 2014, the FASB issued ASU No. 2014-15, Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern. The new guidance requires management of public and private companies to evaluate whether there is substantial doubt about the entity’s ability to continue as a going concern and, if so, disclose that fact. Management will also be required to evaluate and disclose whether its plans alleviate that doubt. The standard will be effective for the Company’s annual period ending December 31, 2016 and interim and annual periods thereafter. Early adoption is permitted. The Company does not expect that the requirement will have an impact on its financial position, results of operations or cash flows.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard is effective for the Company’s annual and interim reporting periods beginning January 1, 2017. Early adoption is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is evaluating the effect that ASU 2014-09 will have on its consolidated financial statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

## 2. Fair Value Measurements

The Company carries short-term investments consisting of marketable securities at fair value on a recurring basis. Fair value is based on the price that would be received from selling an asset in an orderly transaction between market participants at the measurement date. Fair value is estimated by applying the following hierarchy, which prioritizes the inputs used to measure fair value into three levels and bases the categorization within the hierarchy upon the lowest level of input that is available and significant to the fair value measurement:

Level 1 — Observable inputs which include unadjusted quoted prices in active markets for identical assets.

Level 2 — Observable inputs other than Level 1 inputs, such as quoted prices for similar assets, quoted prices for identical or similar assets 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.

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 fair value of assets carried at fair value was determined using the following inputs (in thousands):

	March 31, 2015	
	Total	Level 1
Assets		
Short-term investments:		
U.S. Treasury bills	\$ 19,999	\$ 19,999
	December 31, 2014	
	Total	Level 1
Assets		
Short-term investments:		
U.S. Treasury bills	\$ 20,000	\$ 20,000

## 3. Short-Term Investments

The Company classifies all investments with maturities of three months or less from date of purchase as cash equivalents and all investments with maturities of greater than three months from the date of purchase as short-term investments. The Company classifies its investments in marketable securities as available-for-sale at the time of purchase and as a result, classifies such investments, including securities with maturities beyond twelve months, as current assets in the accompanying condensed consolidated balance sheets.



Table of Contents

As of March 31, 2015, short-term investments consisted of the following (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Aggregate Fair Value
U.S. Treasury bills	\$20,000	\$—	\$(1 )	\$19,999

As of March 31, 2015, the Company's short-term investments will mature in approximately 44 days.

## 4. Financial Statement Components

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

	March 31, 2015	December 31, 2014
Trade accounts receivable	\$8,000	\$7,482
Unbilled trade accounts receivable, net of advance client deposits	749	918
Allowance for doubtful accounts	(30 )	(65 )
Accounts receivable, net	\$8,719	\$8,335

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

	March 31, 2015	December 31, 2014
Computer and network equipment	\$25,590	\$24,292
Computer software	2,439	2,264
Furniture and fixtures	1,036	1,030
Leasehold improvements	611	611
Property and equipment	29,676	28,197
Accumulated depreciation and amortization	(17,250 )	(15,626 )
Property and equipment, net	\$12,426	\$12,571

Depreciation and amortization expense associated with property and equipment was \$1.6 million and \$1.5 million for the three months ended March 31, 2015 and 2014, respectively,

Property and equipment capitalized under capital lease obligations consist primarily of computer and network equipment and were as follows (in thousands):

	March 31, 2015	December 31, 2014
Gross	\$22,328	\$21,025
Less: accumulated depreciation and amortization	(11,983 )	(10,609 )
Total	\$10,345	\$10,416

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

	March 31, 2015	December 31, 2014
Accrued expenses	\$2,245	\$2,240
Accrued compensation and benefits	5,862	5,078
Accrued and other current liabilities	\$8,107	\$7,318
Restricted Cash		

As of March 31, 2015 and December 31, 2014, the Company had \$0.2 million and \$0.1 million of restricted cash, respectively, under letters of credit primarily related to an insurance policy. As of December 31, 2014, the Company also had restricted cash of \$0.7 million related to a letter of credit issued to the Company's landlord with

Table of Contents

respect to its lease obligation, which was released in the three months ended March 31, 2015. Restricted cash is included in other assets on the accompanying condensed consolidated balance sheets.

## 5. Intangible Assets

The components of intangible assets, which were acquired in connection with the Company's acquisition of Face It, Corp., which we refer to as SoCoCare, a social engagement and mobile customer care solution provider, in October 2013, were as follows (in thousands):

	March 31, 2015			December 31, 2014		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	\$2,460	\$(511)	\$1,949	\$2,460	\$(423)	\$2,037
Customer relationships	520	(151)	369	520	(125)	395
Domain names	50	(15)	35	50	(12)	38
Non-compete agreements	140	(68)	72	140	(57)	83
Total	\$3,170	\$(745)	\$2,425	\$3,170	\$(617)	\$2,553

Amortization expense related to intangible assets was \$0.1 million for each of the three months ended March 31, 2015 and 2014. As of March 31, 2015, the expected future amortization expense for intangible assets was as follows (in thousands):

Period	Expected Future Amortization Expense
Remainder of 2015	\$384
2016	503
2017	465
2018	442
2019	351
2020	280
Total	\$2,425

## 6. Long-Term Debt

## 2013 Loan and Security Agreement

Prior to December 2014, the Company's revolving line of credit was under a loan and security agreement ("2013 Loan and Security Agreement") with a lender, which was entered into in March 2013 and amended in October 2013 and February 2014.

In December 2014, the Company entered into a third amendment ("Third Amendment") to the 2013 Loan and Security Agreement with the lender to amend this revolving line of credit to, among other things, (a) increase the revolving credit commitment from \$12.5 million to \$20.0 million, (b) extend the March 2015 maturity date to December 1, 2016 and (c) reduce the interest rate on borrowings by 0.75%, such that the per annum interest rate on outstanding borrowings will be the prime rate plus 0.50%. The Third Amendment also increases the required cash deposit with the bank by \$2.0 million to \$7.5 million.

The 2013 Loan and Security Agreement is collateralized by substantially all the assets of the Company. Under the terms of the amended revolving line of credit ("Revolving Credit Facility"), the balance outstanding cannot exceed the lesser of (i) \$20.0 million or (ii) an amount equal to the Company's monthly recurring revenue for the three months prior multiplied by the average Dollar-Based Retention Rate over the prior twelve months, less the amount accrued for the Company's USF obligation (accrued federal fees). As of March 31, 2015, the outstanding principal balance under the Revolving Credit Facility was \$12.5 million, which has been disclosed as a non-current liability, and the amount available for additional borrowings was \$7.5 million.





Table of Contents

In connection with its acquisition of SoCoCare, the Company also borrowed \$5.0 million under a term loan (the "Term Loan") under the 2013 Loan and Security Agreement in October 2013. Monthly interest-only payments were due on the advance at the prime rate plus 1.50% through September 2014. Principal and interest payments are due in equal monthly installments from October 2014 through the maturity of the Term Loan in March 2017. As of March 31, 2015 and December 31, 2014, approximately \$4.0 million and \$4.5 million, respectively, of this Term Loan was outstanding and is included as notes payable in the condensed consolidated balance sheets. In connection with the Term Loan, the Company issued a warrant to purchase 52,054 shares of its Series D-2 convertible preferred stock at an exercise price of \$1.441 per share. The issuance date fair value of this warrant of \$0.1 million was recorded as a discount against the debt and is being recognized as additional interest expense over the term of the Term Loan. Upon the effectiveness of the Company's registration statement filed with the SEC, the conversion of the Company's preferred stock into common stock and the effectiveness of the 4:1 reverse stock split on April 3, 2014, this warrant became a warrant to purchase 13,013 shares of common stock at an exercise price of \$5.76 per share.

The 2013 Loan and Security Agreement contains certain covenants, including the requirement that the Company maintain \$7.5 million of cash deposited with the lender for the term of the 2013 Loan and Security Agreement. The Company was in compliance with these covenants as of March 31, 2015. The 2013 Loan and Security Agreement remains senior to other debts, including the debt issued under the 2014 Loan and Security Agreement discussed below.

**2014 Loan and Security Agreement**

The Company has a term loan facility of \$30.0 million with a syndicate of two lenders ("Lenders"), which was entered into in February 2014 and amended in December 2014 and February 2015 (the "2014 Loan and Security Agreement"). The term loan facility is available to the Company in tranches; the first tranche for \$20.0 million was advanced upon the closing of the agreement and the remaining \$10.0 million is available for drawdown by the Company until February 2016 in \$1.0 million increments. The Company incurred \$0.4 million in debt issuance costs in connection with borrowing the first tranche in February 2014. The term loan bears interest at a variable per annum rate equal to the greater of 10% or LIBOR plus 9%. Interest is due and payable on the last business day of each month during the term of the loan commencing in February 2014. Monthly principal payments are due beginning in February 2016 based on 1/60th of the outstanding balance at that time and will continue until all remaining principal outstanding under the term loan becomes due and payable in February 2019. All amounts outstanding under this loan facility have been disclosed as part of 'Notes payable - less current portion' in the condensed consolidated balance sheet as of March 31, 2015.

The term loan is secured by substantially all the assets of the Company and is subordinate to the 2013 Loan and Security Agreement. The 2014 Loan and Security Agreement contains certain covenants and includes the occurrence of a material adverse event, as defined in the agreement and determined by the Lenders, as an event of default. As of March 31, 2015, the Company was in compliance with these covenants.

In connection with entering into the 2014 Loan and Security Agreement, the Company issued to the Lenders warrants to purchase 177,865 shares of common stock at \$10.12 per share, which vest and become exercisable over a ten year term from the date of issuance, based on amounts drawn under the \$30.0 million term loan facility. The exercise price of such warrants was subject to adjustment in the event of issuances of common stock by the Company at a price lower than the exercise price of such warrants any time prior to the date of effectiveness of the Company's initial public offering ("IPO") and other corporate actions. Therefore, upon issuance the warrants were classified as a liability to the Company, which has been reclassified to additional paid-in capital upon the Company's IPO at which time these warrants were indexed to the Company's common stock. Based on the drawdown of \$20.0 million in February 2014, 118,577 shares of common stock issuable under the warrants vested and are exercisable by the Lenders. The fair value of the vested warrants of \$1.0 million was recorded as a discount against the debt proceeds and is being recognized as additional interest expense over the term of the loan. As of March 31, 2015, 59,288 shares of common stock issuable under the warrants pertaining to the undrawn \$10.0 million remain unvested.

**Promissory Note**

In July 2013, the Company issued a promissory note to the Universal Service Administrative Company ("USAC") for \$4.1 million as a financing arrangement for that amount of accrued federal fees. The promissory note carries a fixed

annual interest rate of 12.75% and is repayable in 42 equal monthly installments of principal and interest beginning in August 2013. As of March 31, 2015 and December 31, 2014, approximately \$2.4 million and

Table of Contents

\$2.6 million, respectively, of this promissory note was outstanding and is included as notes payable in the accompanying condensed consolidated balance sheets.

As of March 31, 2015 and December 31, 2014, the Company's outstanding debt is summarized as follows (in thousands):

	March 31, 2015	December 31, 2014
Term loan under 2014 Loan and Security Agreement	\$20,000	\$20,000
Term loan under 2013 Loan and Security Agreement	4,000	4,500
Promissory note to USAC	2,358	2,640
Revolving line of credit, non-current	12,500	12,500
Total debt	38,858	39,640
Less: discount	(1,132)	(1,216)
Total debt, net carrying value	\$37,726	\$38,424
Less: current portion of debt	(3,528)	(3,146)
Total debt, less current portion	34,198	35,278

Maturities of the Company's outstanding debt as of March 31, 2015 are as follows (in thousands):

Period	Amount to Mature
Remainder of 2015	\$2,398
2016	19,507
2017	4,620
2018	4,000
2019	8,333
Total	\$38,858

## 7. Stockholders' Equity

### Capital Structure

The Company is authorized to issue 450,000,000 shares of common stock with a par value of \$0.001 per share. As of March 31, 2015, the Company had 49,611,533 shares of common stock issued and outstanding.

The Company is also authorized to designate and issue up to 5,000,000 shares of preferred stock with a par value of \$0.001 per share in one or more series without stockholder approval and to fix the rights, preferences, privileges and restrictions thereof. As of March 31, 2015, the Company had no shares of preferred stock issued and outstanding.

### Common Stock Subject to Forfeiture

In connection with employment and service agreements entered into in connection with the Company's acquisition of SoCoCare in October 2013 ("Acquisition Date"), the Company issued 118,577 shares of unvested restricted common stock, the vesting of which is contingent upon continuing employment or services and subject to forfeiture. During October 2014, 50% of such shares vested. During the three months ended March 31, 2015, in accordance with the applicable stock issuance agreement, the vesting on 37,905 shares accelerated in connection with the termination of employment of a shareholder. The remaining 21,384 shares will vest on the second anniversary of the Acquisition Date, provided the recipients thereof continue in service to the Company through such date. These shares were valued at \$8.48 per share, based on the Acquisition Date fair value of the Company's common stock. This amount is being recorded as stock-based compensation on a straight-line basis over the requisite service periods. For each of the three months ended March 31, 2015 and 2014, \$0.2 million was included as stock-based compensation expense related to these shares. As of March 31, 2015 and December 31, 2014, the 21,384 shares and 59,289 shares that were subject to forfeiture were included in issued and outstanding shares of common stock, respectively.

Table of Contents

## Warrants

As of March 31, 2015 and December 31, 2014, the Company had outstanding warrants to purchase 359,596 shares of common stock with a weighted-average exercise price of \$5.59 per share, which expire on various dates between February 2020 and February 2024.

## Common Stock Reserved for Future Issuance

Shares of common stock reserved for future issuance related to outstanding equity awards, common stock warrants, and employee equity incentive plans were as follows (in thousands):

	March 31, 2015
Stock options outstanding	6,891
Restricted stock units outstanding	1,458
Shares available for future grant under 2014 Plan	5,756
Shares available for future issuance under ESPP	1,217
Common stock warrants outstanding	360
Total shares of common stock reserved	15,682

## Equity Incentive Plans

Prior to the IPO, the Company granted stock options under its Amended and Restated 2004 Equity Incentive Plan, as amended (the "2004 Plan").

In March 2014, the Company's board of directors and stockholders approved the 2014 Equity Incentive Plan ("2014 Plan") and 5,300,000 shares of common stock were reserved for issuance under the 2014 Plan. In addition, on the first day of each year beginning in 2015 and ending in 2024, the 2014 Plan provides for an annual automatic increase to the shares reserved for issuance in an amount equal to 5% of the total number of shares outstanding on December 31st of the preceding calendar year or a lesser number as determined by the Company's board of directors. Pursuant to the automatic annual increase, 2,466,124 additional shares were reserved under the 2014 Plan on January 1, 2015.

Upon the effectiveness of the 2014 Plan on April 3, 2014, no future grants will be made under the 2004 Plan. All shares reserved under the 2004 Plan became available for grant under the 2014 Plan. Any forfeited or expired shares that would otherwise return to the 2004 Plan after the IPO instead return to the 2014 Plan. As of March 31, 2015, 5,756,262 shares of common stock were available for future grant under the 2014 Plan.

The 2004 Plan and the 2014 Plan are described in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

## Stock Options

A summary of the Company's stock option activities during the three months ended March 31, 2015 is as follows (in thousands, except years and per share data):

	Number of Shares Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Outstanding as of December 31, 2014	7,164	\$4.34		
Options granted	—	—		
Options exercised	(209	) 0.55		
Options forfeited or expired	(64	) 6.35		
Outstanding as of March 31, 2015	6,891	\$4.44	7.2	\$15,714

The Company has computed the aggregate intrinsic value amounts disclosed in the above table based on the difference between the original exercise price of the options and the fair market value of the Company's common stock of \$5.56 as of March 31, 2015 for all in-the-money options outstanding.

Table of Contents

## Restricted Stock Units

A summary of the Company's RSU activities during the three months ended March 31, 2015 is as follows (in thousands, except per share data):

	Number of Shares	Weighted Average Grant Date Fair Value Per Share
Outstanding as of December 31, 2014	1,370	\$5.21
RSUs granted	188	4.56
RSUs vested and released	(79 )	5.31
RSUs forfeited	(21 )	4.99
Outstanding as of March 31, 2015	1,458	\$5.13

## Employee Stock Purchase Plan

The Company's 2014 Employee Stock Purchase Plan ("ESPP") became effective on April 3, 2014 and is described in the Company's Annual Report on Form 10-K for the year ended December 31, 2014. The number of shares of common stock originally reserved for issuance under the ESPP was 880,000 shares, which will increase automatically each year, beginning on January 1, 2015 and continuing through January 1, 2024, by the lesser of (i) 1% of the total number of shares of the Company's common stock outstanding on December 31 of the preceding calendar year; (ii) 1,000,000 shares of common stock (subject to adjustment to reflect any split or combination of the Company's common stock); or (iii) such lesser number as determined by the Company's board of directors. Pursuant to the automatic annual increase, 493,224 additional shares were reserved under the ESPP on January 1, 2015. As of March 31, 2015, 1,217,093 shares of common stock were available for future grants under the ESPP.

During the three months ended March 31, 2015, no purchases were made under the ESPP.

## Stock-Based Compensation

Stock-based compensation expenses for the three months ended March 31, 2015 and 2014 are as follows (in thousands):

	Three Months Ended	
	March 31, 2015	March 31, 2014
Cost of revenue	\$188	\$87
Research and development	574	350
Sales and marketing	524	326
General and administrative	949	433
Total stock-based compensation	\$2,235	\$1,196

As of March 31, 2015, unrecognized stock-based compensation expenses by award type, net of estimated forfeitures, and their expected weighted-average recognition periods are summarized in the following table (in thousands, except years).

	Stock Option	RSU	ESPP
Unrecognized stock-based compensation expense	\$9,710	\$5,280	\$131
Weighted-average amortization period	2.7 years	3.4 years	0.1 years

The Company recognizes stock-based compensation expense that is calculated based upon awards ultimately expected to vest and, thus, stock-based compensation expense is reduced for estimated forfeitures. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. All stock-based compensation for equity awards granted to employees and non-employee directors is measured based on the grant date fair value of the award.

The Company values RSUs at the closing market price of its common stock on the date of grant. The Company estimates the fair value of each stock option and purchase right under the ESPP granted to employees on the date of grant using the Black-Scholes option-pricing model and using the assumptions noted in the below table.

Table of Contents

The weighted-average assumptions used to value stock options granted during the three months ended March 31, 2015 and 2014 were as follows:

Stock Options	Three Months Ended	
	March 31, 2015	March 31, 2014
Expected term (years)	*	6.1
Volatility	*	56%
Risk-free interest rate	*	1.8%
Dividend yield	*	—

\* No stock options were granted during the three months ended March 31, 2015.

## 8. Net Loss Per Share

Basic net loss per share is calculated by dividing net loss by the weighted average number of common shares outstanding during the period, and excludes any dilutive effects of employee stock-based awards and warrants. Diluted net income per share is computed giving effect to all potentially dilutive common shares, including common stock issuable upon exercise of stock options and warrants and vesting of restricted stock. As the Company had net losses for the three months ended March 31, 2015 and 2014, all potentially issuable common shares were determined to be anti-dilutive.

The following table presents the calculation of basic and diluted net loss per share (in thousands, except per share data).

	Three Months Ended	
	March 31, 2015	March 31, 2014
Net loss	\$(8,903 )	\$(8,320 )
Weighted-average shares used in computing basic and diluted net loss per share	49,433	5,608
Basic and diluted net loss per share	\$(0.18 )	\$(1.48 )
The following securities were excluded from the calculation of diluted net loss per share attributable to common stockholders because their effect would have been anti-dilutive for the periods presented (in thousands).		
	March 31, 2015	March 31, 2014
Convertible preferred stock	—	30,595
Stock options	6,891	7,345
Restricted stock units	1,458	—
ESPP	171	—
Common stock warrants	360	—
Convertible preferred stock warrants	—	525
Common stock subject to repurchase or forfeiture	21	141
Total	8,901	38,606

## 9. Income Taxes

The provision for income taxes for the three months ended March 31, 2015 and 2014 was approximately \$18 thousand and \$27 thousand, respectively. The provision for income taxes consisted primarily of foreign income taxes.

For the three months ended March 31, 2015 and 2014, the provision for income taxes differed from the statutory amount primarily due to state and foreign taxes currently payable, and the Company realized no benefit for current year losses due to maintaining a full valuation allowance against its domestic and foreign net deferred tax assets.

Table of Contents

The realization of tax benefits of deferred tax assets is dependent upon future levels of taxable income, of an appropriate character, in the periods the items are expected to be deductible or taxable. Based on the available objective evidence, the Company does not believe it is more likely than not that the net deferred tax assets will be realizable. Accordingly, the Company has provided a full valuation allowance against the domestic and foreign net deferred tax assets as of March 31, 2015 and December 31, 2014. The Company intends to maintain the remaining valuation allowance until sufficient positive evidence exists to support a reversal of, or decrease in, the valuation allowance. During the three months ended March 31, 2015, there were no material changes to the total amount of unrecognized tax benefits.

10. Commitments and Contingencies

Commitments

The Company's principal commitments consist of obligations under operating lease agreements for offices, research and development, and sales and marketing facilities, and agreements with third parties to provide co-location hosting and telecommunication usage services. These commitments as of December 31, 2014 are disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2014, and did not change during the three months ended March 31, 2015 except for the acquisition of certain additional data center and network equipment and software under multiple capital leases. As of March 31, 2015, total minimum future payment commitments under these capital leases were approximately \$1.7 million, of which \$0.4 million is due in 2015, with the remainder due over approximately 2.3 years thereafter.

Universal Services Fund Liability

During the third quarter of 2012, the Company determined that based on its business activities, it is classified as a telecommunications service provider for regulatory purposes and it should make direct contributions to the federal Universal Service Fund and related funds ("USF") based on revenues it receives from the resale of interstate and international telecommunications services. Previously, the Company had believed that the telecommunications services were an integral part of an information service that the Company provides via its software and had instead made indirect USF contributions via payments to its wholesale telecommunications service providers. In order to comply with the obligation to make direct contributions, the Company has made a voluntary self-disclosure to the Federal Communications Commission ("FCC") Enforcement Bureau and has registered with the USAC, which is charged by the FCC with administering the USF. The Company has filed exemption certificates with its wholesale telecommunications service providers in order to eliminate its obligation to reimburse such wholesale telecommunications service providers for their USF contributions calculated on services sold to the Company.

The Company's registration with USAC subjects it to assessments for unpaid USF contributions, as well as interest thereon and civil penalties, due to its late registration and past failure to recognize its obligation as a USF contributor and as an international carrier. The Company will be required to pay assessments for periods prior to the Company's registration. While the Company is in administrative proceedings before the FCC to limit such back assessments to the period 2008 through 2012, it is possible that it will be required to pay back assessments for the period from 2003 through 2007. The Company will also face a regulatory and contractual challenge in seeking recovery or credit for its USF reimbursement payments previously made to its wholesale telecommunications service providers of up to \$3.1 million as of March 31, 2015 and December 31, 2014. In 2013, the Company began remitting required contributions on a prospective basis directly to USAC.

In July 2013, the Company and USAC agreed to a financing arrangement for the undisputed portion of the unpaid USF contributions and related interest for the periods 2008 through 2012 whereby the Company issued to USAC a promissory note payable in the amount of \$4.1 million. The repayment terms of the promissory note payable are disclosed in Note 6. As of March 31, 2015, the balance of the promissory note payable was \$2.4 million and is included in the notes payable amounts on the condensed consolidated balance sheets. In addition to the promissory note payable, the Company had an accrued liability for the unpaid USF contributions and related interest and penalties of \$5.5 million and \$5.2 million included in accrued federal fees on the condensed consolidated balance sheets as of March 31, 2015 and December 31, 2014, respectively, of which \$0.8 million pertains to periods prior to 2008. For each of the three months ended March 31, 2015 and 2014, the Company recorded interest and penalty expenses of



\$0.1 million as a charge to general and administrative expense, which were related to its unpaid USF obligations for the periods prior to 2013.

16

---

## Table of Contents

No amounts related to the potential recovery or credit of USF contributions paid by the Company to its wholesale telecommunications service providers were recognized in the accompanying condensed consolidated financial statements.

In connection with the Company's late registration with the USAC and past failure to recognize its obligation as a USF contributor and as an international carrier, in October 2014, the FCC Enforcement Bureau began to negotiate with the Company a consent decree and a civil penalty to conclude its investigation into the Company's 2008 - 2012 USF contribution and international carrier authorization compliance. On October 28, 2014, the FCC Enforcement Bureau and the Company tentatively agreed on a \$2.0 million civil penalty and are negotiating a consent decree to resolve this matter. Principal payments of the civil penalty will likely be payable to the U.S. Treasury over 36 months beginning on the date of execution, which the Company anticipates will be in the course of 2015, under an installment payment plan to be further negotiated by the Company and the FCC Enforcement Bureau. Based on the information that became available in October 2014, the Company believed that this probable loss existed and became reasonably estimable and therefore accrued a liability of \$2.0 million within 'Accrued federal fees' in the condensed consolidated balance sheet in the third quarter of 2014, which was charged to general and administrative expense. There were no changes in this accrued probable loss as of March 31, 2015.

### State and Local Taxes and Surcharges

During 2013, the Company analyzed its activities and determined it may be obligated to collect and remit various state and local taxes and surcharges on its usage-based fees. The Company had not remitted state and local taxes on usage-based fees in any of the periods prior to 2014 and therefore accrued a sales tax liability for this contingency. In January 2014, the Company commenced paying such taxes and surcharges to certain state authorities. In June 2014, the Company commenced collecting state and local taxes or surcharges on usage-based fees from its clients on a current basis and remitting such taxes to the applicable state taxing authorities. During the three months ended March 31, 2015 and 2014, the Company has remitted \$27 thousand and \$0.1 million, respectively, for its state and local taxes on usage-based fees related to the periods prior to June 2014. For the three months ended March 31, 2015 and 2014, the Company recognized general and administrative expense of \$0.1 million and \$0.5 million, respectively, related to its estimated sales tax liability on usage-based fees, which was not being collected from its clients. The Company's estimate of the probable loss incurred under this contingency is based on its analysis of the source location of its usage-based fees and the regulations and rules in each state.

In April 2012, the Company commenced collecting and remitting sales taxes on sales of subscription services in all states in which it determined it was obligated to do so. During the first quarter of 2015, the Company conducted an updated sales tax review of the taxability of sales of its subscription services. As a result, the Company determined that it may be obligated to collect and remit sales taxes on such sales in four additional states. Based on its best estimate of the probable sales tax liability in those four states relating to its sales of subscription services during the period 2011 through 2014, for the three months ended March 31, 2015, the Company recorded a general and administrative expense of \$0.6 million as an out of period adjustment to accrue for such taxes. The accrued tax liability was included in "Sales tax liability" on the condensed consolidated balance sheets. During 2015, the Company expects to commence collecting such state sales taxes from its clients on a current basis and remitting such taxes to the applicable state taxing authorities.

As of March 31, 2015, the Company had total accrued liabilities of \$3.3 million for its contingent state and local sales taxes and surcharges that were not being collected from its clients but may be imposed by various states and municipalities, of which \$1.0 million and \$2.3 million was included in current and non-current "Sales tax liability" on the condensed consolidated balance sheets, respectively. As of December 31, 2014, the Company had total accrued liabilities of \$2.6 million for such contingent state and local sales taxes and surcharges, which was included in non-current "Sales tax liability" on the condensed consolidated balance sheets.

### Legal Matters

The Company is involved in various legal and regulatory matters arising in the normal course of business. In management's opinion, resolution of these matters is not expected to have a material impact on the Company's consolidated results of operations, cash flows, or its financial position. However, depending on the nature and timing of any such dispute, an unfavorable resolution of a matter could materially affect the Company's future consolidated

results of operations, cash flows or financial position in a particular period.  
The Company is currently involved in the following lawsuits as a defendant.

17

---

Table of Contents

## NobelBiz Litigation

In April 2012, NobelBiz, Inc., a telecommunication solutions company, brought a patent infringement lawsuit in the U.S. District Court for the Eastern District of Texas against the Company seeking a permanent injunction, damages and attorneys' fees. The Company responded to the complaint and preliminary injunction request by asserting non-infringement and invalidity of the patent.

In March 2013, the court granted the Company's motion to transfer the case to the U.S. District Court for the Northern District of California subsequent to which the complainant amended its claim to include another related patent. The Company has responded to this amended claim by continuing to assert non-infringement and invalidity of the patents. During December 2013, the court in California held a status conference and subsequently held a claim construction hearing regarding the patents on August 22, 2014. On January 16, 2015, the court issued an order regarding claim construction of the two patents-in-suit, and on April 6, 2015, the court held a case management conference setting further dates in the case. The court set a trial date of June 20, 2016, and set February 16, 2016 as the deadline to file motions for summary judgment. The Company has investigated the claims alleged in the complaint and believes that it has good defenses to the claims. Accordingly, the Company has not accrued a loss related to this matter as the Company does not believe that it is probable that a loss will be incurred.

## UHC Claim

On January 29, 2015, Soneet Kapila, the Chapter 11 Trustee for the estate of Universal Health Care Group, Inc., which entity serves as the sole member of American Managed Care, LLC ("AMC"), filed an adversary complaint against the Company in the United States Bankruptcy Court for the Middle District of Florida. The adversary proceeding, Soneet Kapila v. Five9, Inc., Case No. 13-05952 (KRM), Adv. No. 15-00092 (KRM), sought to avoid and recover as preferential payments, actual fraudulent transfers and/or constructive fraudulent transfers certain payments that the Company allegedly received from AMC in return for services provided by the Company between May 3, 2011 and May 3, 2014. The trustee sought approximately \$2.5 million in damages. The matter has been settled, with Bankruptcy Court approval, for a cash payment by the Company of \$99,000, which has been accrued by the Company with a charge to general and administrative expense during the three months ended March 31, 2015. The accrued liability was included in "Accrued and other current liabilities" on the condensed consolidated balance sheets.

The Company recognizes general and administrative expense for legal fees in the period the services are provided.

## Indemnification Agreements

In the ordinary course of business, the Company indemnifies various clients, vendors, lessors, business partners and other parties with respect to certain matters, including, but not limited to, losses arising out of breach of such agreements, services to be provided by the Company or from intellectual property infringement claims made by third parties. In addition, the Company has entered into indemnification agreements with its directors, officers and certain employees that require the Company, among other things, to indemnify them against certain liabilities that may arise by reason of their status or service as directors, officers or employees. No demands have been made upon the Company to provide indemnification under such agreements and thus there are no claims that the Company is aware of that would have a material effect on the Company's condensed consolidated balance sheets, condensed consolidated statements of operations and comprehensive loss, or condensed consolidated statements of cash flows.

## 11. Geographical Information

The following table is a summary of revenues by geographic region based on client billing address and has been estimated based on the amounts billed to clients during the periods (in thousands).

	Three Months Ended	
	March 31, 2015	March 31, 2014
United States	\$28,279	\$22,434
International	1,995	1,840
Total revenue	\$30,274	\$24,274

Table of Contents

The following table summarizes total property and equipment, net in the respective locations (in thousands).

	March 31, 2015	December 31, 2014
United States	\$10,415	\$10,625
International	2,011	1,946
Property and equipment, net	\$12,426	\$12,571

## ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion in conjunction with the condensed consolidated financial statements and notes thereto included elsewhere in this report and our Annual Report on Form 10-K for the year ended December 31, 2014. In addition to historical information, this discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 that involve risks and uncertainties that could cause our actual results to differ materially from our expectations. Factors that could cause such differences include, but are not limited to, those described in the section titled "Risk Factors" and elsewhere in this report.

### Overview

We are a pioneer and leading provider of cloud software for contact centers, facilitating over three billion interactions between our more than 2,000 clients and their customers per year. We believe we achieved this leadership position through our expertise and technology, which has empowered us to help organizations of all sizes transition from legacy on-premise contact center systems to our cloud solution. Our solution, which is comprised of our Virtual Contact Center ("VCC") cloud platform and applications, allows simultaneous management and optimization of customer interactions across voice, chat, email, web, social media and mobile channels, either directly or through our application programming interfaces. Our VCC cloud platform routes each customer interaction to an appropriate agent resource, and delivers relevant customer data to the agent in real-time to optimize the customer experience. Unlike legacy on-premise contact center systems, our solution requires minimal up-front investment and can be rapidly deployed and adjusted depending on our client's requirements.

Since founding our business in 2001, we have focused exclusively on delivering cloud contact center software. We initially targeted smaller contact center opportunities with our telesales team and, over time, invested in expanding the breadth and depth of the functionality of our cloud platform to meet the evolving requirements of our clients. In 2009, we made a strategic decision to expand our market opportunity to include larger contact centers. This decision drove further investments in research and development and the establishment of our field sales team to meet the requirements of these larger contact centers. We believe this shift has helped us diversify our client base while significantly enhancing our opportunity for future revenue growth. To complement these efforts, we have also focused on building client awareness and driving adoption of our solution through marketing activities, which include internet advertising, digital marketing campaigns, social marketing, trade shows, industry events and telemarketing. In June 2014, we introduced our Summer Release 2014 that includes new native multichannel applications that support social, mobile, chat and email interactions. The multichannel capabilities are powered by Five9 Connect, an intelligent technology layer that helps contact centers evaluate, prioritize and route requests. Our solution also provides more mobility capabilities for supervisors and enables customized call center monitoring and reporting.

We provide our solution through a SaaS business model with recurring subscriptions. We offer a comprehensive suite of applications delivered on our VCC cloud platform that are designed to enable our clients to manage and optimize interactions across inbound and outbound contact centers. We primarily generate revenue by selling subscriptions and related usage of our VCC cloud platform. We charge our clients monthly subscription fees for access to our solution, primarily based on the number of agent seats, as well as the specific functionalities and applications our clients deploy. We define agent seats as the maximum number of named agents allowed to concurrently access our solution. Our clients typically have more named agents than agent seats, and multiple named agents may use an agent seat, though not simultaneously. Substantially all of our clients purchase both subscriptions and related usage from us. A small percentage of our clients subscribe to our platform but purchase telephony usage directly from a wholesale telecommunications service provider. We do not sell telephony usage on a stand-alone basis to any client. The related

usage fees are based on the volume of minutes for inbound and outbound interactions. We also offer bundled plans, generally for smaller deployments, where the client is charged a single monthly fixed fee per agent seat that includes both subscription and unlimited usage in the contiguous 48 states and,

Table of Contents

in some cases, Canada. We offer monthly, annual and multiple-year contracts to our clients, generally with 30 days' notice required for changes in the number of agent seats. Our clients can use this notice period to rapidly adjust the number of agent seats used to meet their changing contact center volume needs, including to reduce the number of agent seats to zero. As a general matter, this means that a client can effectively terminate its agreement with us upon 30 days' notice. Our larger clients typically choose annual contracts, which generally include an implementation and ramp period of several months. Fixed subscription fees, including bundled plans, are generally billed monthly in advance, while related usage fees are billed in arrears. For the three months ended March 31, 2015 and 2014, subscription and related usage fees accounted for 97% and 98% of our revenue, respectively. The remainder was comprised of professional services revenue from the implementation and optimization of our solution.

Our revenue increased to \$30.3 million for the three months ended March 31, 2015 from \$24.3 million for the three months ended March 31, 2014. Revenue growth has primarily been driven by new clients choosing to use our solution and to a lesser extent, existing clients gradually increasing the number of agent seats under subscription. For each of the three months ended March 31, 2015 and 2014, no single client accounted for more than 10% of our total revenue. As of March 31, 2015, we had over 2,000 clients across multiple industries, with subscriptions ranging in size from fewer than 10 agent seats to approximately 800 agent seats.

We have continued to make significant expenditures and investments, including in sales and marketing, research and development and infrastructure. We primarily evaluate the success of our business based on revenue growth and the efficiency and effectiveness of our investments. The growth of our business and our future success depend on many factors, including our ability to continue to expand our client base to include larger opportunities, grow revenue from our existing client base, innovate and expand internationally. While these areas represent significant opportunities for us, they also pose risks and challenges that we must successfully address in order to sustain the growth of our business and improve our operating results.

In order to pursue these opportunities, we anticipate that we will continue to expand our operations and headcount in the near term. The expected addition of new employees and the investments that we anticipate will be necessary to manage our anticipated growth will make it more difficult for us to generate earnings.

Due to our continuing investments to grow our business, increase our sales and marketing efforts, pursue new opportunities, enhance our solution and build our technology, we expect our cost of revenue and operating expenses to increase in absolute dollars in future periods. However, we expect these expenses as a percentage of revenue to decrease as we grow our revenue and gain economies of scale by increasing our client base without direct incremental development costs and by utilizing more of the capacity of our data centers.

**Key Operating and Financial Performance Metrics**

In addition to measures of financial performance presented in our condensed consolidated financial statements, we monitor the key metrics set forth below to help us evaluate growth trends, establish budgets, measure the effectiveness of our sales and marketing efforts and assess operational efficiencies.

**Dollar-Based Retention Rate**

We believe that our Dollar-Based Retention Rate provides insight into our ability to retain and grow revenue from our clients, and is a measure of the long-term value of our client relationships. Our Dollar-Based Retention Rate is calculated by dividing our Retained Net Invoicing by our Retention Base Net Invoicing on a monthly basis, which we then average using the rates for the trailing twelve months for the period being presented. We define Retention Base Net Invoicing as recurring net invoicing from all clients in the comparable prior year period, and we define Retained Net Invoicing as recurring net invoicing from that same group of clients in the current period. We define recurring net invoicing as subscription and related usage revenue excluding the impact of service credits, reserves and deferrals. Historically, the difference between recurring net invoicing and our subscription and related usage revenue has been within 10%.

The following table shows our Dollar-Based Retention Rate for the periods presented:

	Twelve Months Ended	
	March 31, 2015	March 31, 2014
Dollar-Based Retention Rate	95%	100%





Table of Contents

Our Dollar-Based Retention Rate declined as of March 31, 2015 primarily due to a reduction in usage revenue during the period from one current client due to the competitive pricing environment on international calling and a business process outsourcer customer that went out of business.

**Adjusted EBITDA**

We monitor Adjusted EBITDA, a non-GAAP financial measure, to analyze our financial results and believe that it is useful to investors, as a supplement to U.S. GAAP measures, in evaluating our ongoing operational performance and enhancing an overall understanding of our past financial performance. We believe that Adjusted EBITDA helps illustrate underlying trends in our business that could otherwise be masked by the effect of the income or expenses that we exclude from Adjusted EBITDA. Furthermore, we use this measure to establish budgets and operational goals for managing our business and evaluating our performance. We also believe that Adjusted EBITDA provides an additional tool for investors to use in comparing our recurring core business operating results over multiple periods with other companies in our industry.

Adjusted EBITDA should not be considered in isolation from, or as a substitute for, financial information prepared in accordance with U.S. GAAP and our calculation of Adjusted EBITDA may differ from that of other companies in our industry. We compensate for the inherent limitations associated with using Adjusted EBITDA through disclosure of these limitations, presentation of our financial statements in accordance with U.S. GAAP and reconciliation of Adjusted EBITDA to the most directly comparable U.S. GAAP measure, net loss. We calculate Adjusted EBITDA as net loss before (1) depreciation and amortization, (2) stock-based compensation, (3) other income (expense), net, (4) provision for income taxes, and (5) other unusual items that do not directly affect what we consider to be our core operating performance.

The following table shows a reconciliation from net loss to Adjusted EBITDA for the periods presented (in thousands):

	Three Months Ended	
	March 31, 2015	March 31, 2014
Net loss	\$(8,903)	\$(8,320)
Non-GAAP adjustments:		
Depreciation and amortization <sup>(1)</sup>	1,775	1,592
Stock-based compensation <sup>(2)</sup>	2,235	1,196
Interest expense	1,139	778
Interest income and other	(2)	(32)
Provision for income taxes	18	27
Change in fair value of convertible preferred and common stock warrant liabilities	—	(1,745)
Out of period adjustment for sales tax liability <sup>(3)</sup>	575	—
Adjusted EBITDA	\$(3,163)	\$(6,504)

(1) Depreciation and amortization expenses included in our results of operations are as follows (in thousands):

	Three Months Ended	
	March 31, 2015	March 31, 2014
Cost of revenue	\$1,439	\$1,202
Research and development	87	46
Sales and marketing	49	48
General and administrative	200	296
Total depreciation and amortization	\$1,775	\$1,592

(2) See Note 7 of the notes to the condensed consolidated financial statements for stock-based compensation expense included in our results of operations for the periods presented.

(3) Included in general and administrative expense. This amount represents an out of period adjustment for 2011 through 2014. See Note 10 of the notes to the condensed consolidated financial statements included in this report.



## Table of Contents

### Key Components of Our Results of Operations

#### Revenue

Our revenue consists of subscription and related usage as well as professional services. We consider our subscription and related usage to be recurring. This recurring revenue includes fixed subscription fees for the delivery and support of our VCC cloud platform, as well as related usage fees. The related usage fees are based on the volume of minutes for inbound and outbound client interactions. We also offer bundled plans, generally for smaller deployments, where the client is charged a single monthly fixed fee per agent seat that includes both subscription and unlimited usage in the contiguous 48 states and, in some cases, Canada. We offer monthly, annual and multiple-year contracts for our clients, generally with 30 days' notice required for changes in the number of agent seats. Our clients can use this notice period to rapidly adjust the number of agent seats used to meet their changing contact center volume needs, including to reduce the number of agent seats to zero. As a general matter, this means that a client can effectively terminate its agreement with us upon 30 days' notice.

Fixed subscription fees, including plans with bundled usage, are generally billed monthly in advance, while variable usage fees are billed in arrears. Fixed subscription fees are recognized on a straight-line basis over the applicable term, predominantly the monthly contractual billing period. Support activities include technical assistance for our solution and upgrades and enhancements on a when and if available basis, which are not billed separately. Variable subscription related usage fees for non-bundled plans are billed in arrears based on client-specific per minute rate plans and are recognized as actual usage occurs. We generally require advance deposits from clients based on estimated usage. All fees, except usage deposits, are non-refundable.

In addition, we generate professional services revenue from assisting clients in implementing our solution and optimizing use. These services include application configuration, system integration and education and training services. Professional services are primarily billed on a fixed-fee basis and are typically performed by us directly. In limited cases, our clients may choose to perform these services themselves or engage their own third-party service providers to perform such services. Professional services are recognized as the services are performed using the proportional performance method, with performance measured based on hours of work performed, provided all other criteria for revenue recognition are met.

#### Cost of Revenue

Our cost of revenue consists primarily of fees that we pay to telecommunications providers for usage, personnel costs (including stock-based compensation), costs to build out and maintain co-location data centers, depreciation and related expenses of the servers and equipment, USF contributions and other regulatory costs, allocated office and facility costs and amortization of acquired technology. Cost of revenue can fluctuate based on a number of factors, including the fees we pay to telecommunications providers, which vary depending on our clients' usage of our VCC cloud platform, the timing of capital expenditures and related depreciation charges and changes in headcount. We expect to continue investing in our network infrastructure and operations and client support function to maintain high quality and availability of service. As our business grows, we expect to realize economies of scale in network infrastructure, personnel and client support.

#### Operating Expenses

We classify our operating expenses as research and development, sales and marketing and general and administrative expenses.

**Research and Development.** Our research and development expenses consist primarily of salary and related expenses (including stock-based compensation) for personnel related to the development of improvements and expanded features for our services, as well as quality assurance, testing, product management and allocated overhead. We expense research and development expenses as they are incurred. We believe that continued investment in our solution is important for our future growth, and we expect research and development expenses to increase in absolute dollars in the foreseeable future, although these expenses as a percentage of our revenue are expected to decrease over time.

**Sales and Marketing.** Sales and marketing expenses consist primarily of salaries and related expenses (including stock-based compensation) for employees in sales and marketing, including commissions and bonuses, as well as

advertising, marketing, corporate communications, travel costs and allocated overhead. We expense the costs of sales commissions associated with the acquisition or renewal of client contracts as incurred in the period the

Table of Contents

contract is acquired or the renewal occurs. We believe it is important to continue investing in sales and marketing to continue to generate revenue growth. Accordingly, we expect sales and marketing expenses to increase in absolute dollars as we continue to support our growth initiatives, although these expenses as a percentage of our revenue are expected to decrease over time.

**General and Administrative.** General and administrative expenses consist primarily of salary and related expenses (including stock-based compensation) for management, finance and accounting, legal, information systems and human resources personnel, professional fees, compliance costs, other corporate expenses and allocated overhead. We expect that general and administrative expenses will fluctuate in absolute dollars from period to period but decline as a percentage of revenue over time.

**Other Income (Expense), Net**

Other income (expense), net consists primarily of interest expense associated with our debt and capital leases and change in fair value of convertible preferred and common stock warrant liabilities. As a result of our \$20.0 million term loan borrowed in February 2014 (See Note 6 of the notes to condensed consolidated financial statements of this Form 10-Q) and our continued capital spending funded by capital leases, we expect interest expense to increase in absolute dollars.

**Change in Fair Value of Convertible Preferred and Common Stock Warrant Liabilities.** Prior to our IPO, we had outstanding warrants to purchase shares of our convertible preferred stock and common stock which were classified as liabilities. These warrants were subject to re-measurement at each balance sheet date, and any change in fair value was recognized as a component of other income (expense), net. In connection with our IPO in April 2014, these liability-classified warrants became equity-classified and accordingly the associated liability was reclassified to additional paid-in capital. After the IPO, we are no longer required to re-measure the fair value of the warrant liability, therefore, beginning with the three months ended June 30, 2014, no further charges or credits related to such warrants have been or will be made to other income (expense), net.

**Provision for Income Taxes**

Our provision for income taxes consists primarily of corporate income taxes resulting from profits generated in foreign jurisdictions by our wholly-owned subsidiaries, along with state income taxes payable in the United States.

Table of Contents

## Results of Operations for the Three Months Ended March 31, 2015 and 2014

Based on the condensed consolidated statements of operations and comprehensive loss set forth in this quarterly report, the following table sets forth our operating results as a percentage of revenue for the periods indicated:

	Three Months Ended			
	March 31, 2015		March 31, 2014	
Revenue	100	%	100	%
Cost of revenue	49	%	54	%
Gross profit	51	%	46	%
Operating expenses:				
Research and development	20	%	22	%
Sales and marketing	33	%	37	%
General and administrative	24	%	25	%
Total operating expenses	77	%	84	%
Loss from operations	(26)	)%	(38)	)%
Other income (expense), net:				
Change in fair value of convertible preferred and common stock warrant liabilities	—	%	7	%
Interest expense	(4)	)%	(3)	)%
Interest income and other	1	%	—	%
Total other income (expense), net	(3)	)%	4	%
Loss before provision for income taxes	(29)	)%	(34)	)%
Provision for income taxes	—	%	—	%
Net loss	(29)	)%	(34)	)%
Revenue				

	Three Months Ended			
	March 31, 2015	March 31, 2014	\$ Change	% Change

(in thousands, except percentages)

Revenue	\$30,274	\$24,274	\$6,000	25%
---------	----------	----------	---------	-----

The increase in revenue for the three months ended March 31, 2015 compared to the same period of 2014 was attributable to revenue from new clients acquired since April 1, 2014, which was primarily driven by an increase in sales and marketing activities in the twelve months ended March 31, 2015. Our average pricing remained relatively consistent between these periods.

## Cost of Revenue

	Three Months Ended			
	March 31, 2015	March 31, 2014	\$ Change	% Change

(in thousands, except percentages)

Cost of revenue	\$14,778	\$13,148	\$1,630	12%
% of Revenue	49%	54%		

The increase in cost of revenue for the three months ended March 31, 2015 compared to the same period of 2014 was primarily due to a \$1.0 million increase in personnel costs driven by increased headcount, a \$0.3 million increase in third party hosted software costs due to increased client activities, a \$0.3 million increase in USF contribution and other federal telecommunication service fees primarily due to increased client usage, and a \$0.2 million increase in depreciation expenses for servers and equipment due to additional investments in technical



Table of Contents

infrastructure to support current and expected future client growth. The remainder of the increase was primarily due to our business growth and system implementations. These increases were offset in part by a \$0.5 million decrease in telecommunication carrier costs relating to our clients' long distance call usage due to improved usage efficiencies.

## Gross Profit

	Three Months Ended			
	March 31, 2015	March 31, 2014	\$ Change	% Change
	(in thousands, except percentages)			
Gross profit	\$15,496	\$11,126	\$4,370	39%
% of Revenue	51%	46%		

For the three months ended March 31, 2015, the increase in gross margin was primarily due to improved usage efficiencies and continued benefit from economies of scale.

## Operating Expenses

## Research and Development

	Three Months Ended			
	March 31, 2015	March 31, 2014	\$ Change	% Change
	(in thousands, except percentages)			
Research and development	\$6,038	\$5,225	\$813	16%
% of Revenue	20%	22%		

The increase in research and development expenses for the three months ended March 31, 2015 compared to the same period of 2014 was primarily due to a \$0.6 million increase in personnel-related costs driven primarily by increased headcount and a \$0.2 million increase in stock-based compensation expense primarily due to an increase in the fair value of employee equity awards.

## Sales and Marketing

	Three Months Ended			
	March 31, 2015	March 31, 2014	\$ Change	% Change
	(in thousands, except percentages)			
Sales and marketing	\$9,931	\$9,022	\$909	10%
% of Revenue	33%	37%		

The increase in sales and marketing expenses for the three months ended March 31, 2015 compared to the same period of 2014 was primarily due to a \$0.4 million increase in personnel costs resulting from headcount additions, a \$0.3 million increase in commissions paid to sales personnel driven by the growth in sales of our solution, a \$0.2 million increase in stock-based compensation expense due to increased headcount as well as an increase in the fair value of employee equity awards. The increases in headcount supported our growth strategy to acquire new client and increase the number of agent seats within our existing client base. We increased marketing efforts to raise brand awareness and lead generation efforts.

## General and Administrative

	Three Months Ended			
	March 31, 2015	March 31, 2014	\$ Change	% Change
	(in thousands, except percentages)			
General and administrative	\$7,275	\$6,171	\$1,104	18%
% of Revenue	24%	25%		





Table of Contents

The increase in general and administrative expenses for the three months ended March 31, 2015 compared to the same period of 2014 was primarily due to a \$0.6 million increase in personnel costs due to headcount additions required to operate as a public company since our IPO in April 2014, a \$0.5 million increase in stock-based compensation expense due to headcount additions as well as an increase in the fair value of employee equity awards, and a \$0.3 million increase in contingent state and local taxes and surcharges, which was primarily the net effect of a \$0.6 million out of period adjustment recorded in the first quarter of 2015 for additional sales taxes in four U.S. states for certain revenue earned during the period 2011 through 2014 and a \$0.3 million decrease in such taxes accrued for our usage-based fees as we commenced collecting state and local taxes and surcharges from our clients for applicable states in June 2014 (see Note 10 of the notes to our condensed consolidated financial statements). These increases were partially offset by a \$0.4 million decrease in outside professional services fees due to higher legal and accounting costs incurred in the three months ended March 31, 2014 in connection with our IPO.

## Other Income (Expense), Net

	Three Months Ended		\$ Change	% Change
	March 31, 2015	March 31, 2014		
	(in thousands, except percentages)			
Change in fair value of convertible preferred and common stock warrant liabilities	\$—	\$1,745	\$(1,745)	(100)%
Interest expense	(1,139)	(778)	(361)	46%
Interest income and other	2	32	(30)	(94)%
Total other income (expense), net	\$(1,137)	\$999	\$(2,136)	(214)%
% of Revenue	(3)%	4%		

For the three months ended March 31, 2015, interest expense increased as a result of a higher average balance of outstanding debt. In February 2014, we borrowed a \$20.0 million term loan under a loan and security agreement. See Note 6 of the notes to our condensed consolidated financial statements.

## Liquidity and Capital Resources

To date, we have financed our operations primarily through sales of our solution, net proceeds from the issuance of our convertible preferred stock, lease facilities and, more recently, net proceeds raised from our IPO and debt financings. As of March 31, 2015, we had cash and available-for-sale short-term investments totaling \$70.6 million. In April 2014, we consummated our IPO and received aggregate proceeds of \$74.9 million after deducting underwriters' discounts and commissions of \$5.6 million, but before deduction of offering expenses of approximately \$4.2 million, of which \$0.8 million was paid by us prior to 2014 and the remaining \$3.4 million was paid in the first two quarters of 2014.

We maintain a revolving line of credit of \$20.0 million with a bank under our 2013 Loan and Security Agreement. As of March 31, 2015, we had borrowed \$12.5 million under this facility and the amount available for additional borrowings was \$7.5 million. The 2013 Loan and Security Agreement contains certain covenants, including the requirement that we maintain \$7.5 million of cash deposited with the lender for the term of the agreement and includes the occurrence of a material adverse effect, as defined in the agreement and determined by the lender, as an event of default. As of March 31, 2015, we were in compliance with these covenants. See Note 6 of the notes to condensed consolidated financial statements of this Form 10-Q.

We also have a term loan facility of \$30.0 million under our 2014 Loan and Security Agreement that was entered into with a syndicate of two lenders ("Lenders") in February 2014 and amended in December 2014 and February 2015. At closing in February 2014, we borrowed \$20.0 million from the term loan facility with the remaining \$10.0 million available to be borrowed until February 2016. The 2014 Loan and Security Agreement contains certain covenants and includes the occurrence of a material adverse event, as defined in the agreement and determined by the Lenders, as an event of default. As of March 31, 2015, we were in compliance with these covenants.



Table of Contents

We believe our existing cash, available-for-sale short-term investments and the amounts available for borrowing under our term loan facility and our revolving line of credit will be sufficient to meet our working capital and capital expenditure needs at least through March 31, 2016. Our future capital requirements will depend on many factors including our growth rate, continuing market acceptance of our solution, client retention, ability to gain new clients, the timing and extent of spending to support development efforts, the expansion of sales and marketing activities and the introduction of new and enhanced offerings. We may also acquire or invest in complementary businesses, technologies and intellectual property rights, which may increase our future capital requirements, both to pay acquisition costs and to support our combined operations. We may be required to seek additional equity or debt financing. In the event that additional financing is required, we may not be able to raise it on terms acceptable to us or at all. If we are unable to raise additional capital when desired, our business, operating results, and financial condition would be harmed. In addition, if our operating performance during the next twelve months is below our expectations, our liquidity and ability to operate our business could be harmed.

If we raise additional funds by issuing equity or equity-linked securities, the ownership of our existing stockholders will be diluted. If we raise additional funds through the incurrence of indebtedness, we will be subject to increased debt service obligations and could also be subject to restrictive covenants, such as limitations on our ability to incur additional debt, and other operating restrictions that could harm our ability to conduct our business.

**Cash Flows**

The following table summarizes our cash flows for the periods presented (in thousands, except percentages):

	Three Months Ended		\$ Change	% Change
	March 31, 2015	March 31, 2014		
Net cash used in operating activities	\$ (5,753	) \$ (6,180	) \$ 427	(7 )%
Net cash provided by (used in) investing activities	462	(96	) 558	(581 )%
Net cash provided by (used in) financing activities	(2,352	) 17,766	(20,118	) (113 )%
Net increase (decrease) in cash and cash equivalents	\$ (7,643	) \$ 11,490	\$ (19,133	) (167 )%

**Cash Flows from Operating Activities**

Cash used in operating activities is significantly influenced by the amount of cash we invest in personnel and infrastructure to support the anticipated growth of our business and the amount and timing of client payments. As we continue to invest in personnel and infrastructure to support the anticipated growth of our business, we expect net uses of cash by operations to continue. Our largest source of operating cash inflows is cash collections from our clients for subscription and related usage services. Payments from clients for these services are typically received monthly. For the three months ended March 31, 2015 and 2014, our days-sales-outstanding were 24 and 22 days, respectively. During the three months ended March 31, 2015, net cash used in operating activities decreased by \$0.4 million compared to the same period of 2014 primarily due to a \$2.5 million decrease in net loss after adjusting for non-cash expenses and a \$2.1 million increase in net cash outflows resulting from changes in operating assets and liabilities. During the three months ended March 31, 2015, cash outflows from changes in operating assets and liabilities included primarily a \$1.6 million decrease in accounts payable related to timing of liabilities and payments, a \$1.2 million increase in prepaid expenses and other current assets primarily related to long-term maintenance contracts and annual subscription fees on third-party licensed technology and insurance policies, and a \$0.5 million increase in accounts receivable due to increased sales. Cash inflows from changes in operating assets and liabilities included a \$1.1 million increase in accrued and other liabilities primarily for ESPP withholdings for employees for the purchase period started in November 2014 and additional employee paid-time-off liability due to timing of usage, a \$1.0 million increase in accrued federal fees and sales tax liability as a result of a \$0.6 million out of period adjustment for additional sales tax liability recorded in the first quarter of 2015 (see Note 10 of the notes to condensed consolidated financial statements included in this Form 10-Q), as well as increased client usage, and a \$0.3 million increase in deferred revenue primarily attributable to increased billings.

During the three months ended March 31, 2014, cash outflows from changes in operating assets and liabilities included a \$1.0 million increase in prepaid expenses and other current assets primarily related to long-term maintenance contracts and annual subscription fees on third-party licensed technology. Cash inflows from changes



## Table of Contents

in operating assets and liabilities included a \$0.9 million increase in accrued and other liabilities primarily for increased audit and legal fees as we prepared to become a public company and for increased third-party software costs due to upgrading existing software and purchasing new software to support our growth, a \$0.6 million increase in deferred revenue primarily attributable to increased billings, and a \$0.5 million increase in accrued federal fees and sales tax liability as a result of increased client usage.

### Cash Flows from Investing Activities

Net cash provided by investing activities in the three months ended March 31, 2015 was primarily from proceeds of \$20.0 million from maturity of short-term investments and a \$0.7 million decrease in restricted cash due to the release of a letter of credit issued to our landlord with respect to our office lease obligation, offset in part by purchase of short-term investments of \$20.0 million and purchase of property and equipment of \$0.2 million.

Net cash used in investing activities in the three months ended March 31, 2014 was primarily for purchase of property and equipment of \$0.1 million.

### Cash Flows from Financing Activities

During the three months ended March 31, 2015, cash used in financing activities of \$2.4 million was primarily for repayments of \$2.5 million on our capital lease and notes payable obligations.

During the three months ended March 31, 2014, cash provided by financing activities of \$17.8 million was primarily attributable to net proceeds of \$19.6 million from a term loan under our 2014 Loan and Security Agreement, and cash received from stock exercises of \$0.6 million. These increases were partially offset by \$1.5 million in repayments on our capital lease and notes payable obligations and \$0.8 million payments for deferred offering costs in connection with our IPO.

### Critical Accounting Policies and Estimates

Our condensed consolidated financial statements are prepared in accordance with U.S. GAAP. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, expenses and related disclosures. On an ongoing basis, we evaluate our estimates and assumptions. Our actual results may differ from these estimates under different assumptions or conditions.

We believe our critical accounting policies involve the greatest degree of judgment and complexity and have the greatest potential impact on our consolidated financial statements. Our critical accounting policies are disclosed in our Annual Report on Form 10-K for the year ended December 31, 2014. During the three months ended March 31, 2015, our critical accounting policies did not materially change.

### Recent Accounting Pronouncements

In April 2015, the FASB issued ASU No. 2015-05, Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement. The ASU provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The ASU does not change the accounting for a customer's accounting for service contracts. A company can elect to adopt the ASU either prospectively or retrospectively. This guidance is effective for us beginning in the first quarter of 2016. Early adoption is permitted. We do not expect this guidance to have a material effect on our consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. The ASU requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by this ASU. Early adoption is permitted. This guidance is effective for us on a retrospective basis beginning in the first quarter of 2016 and is not expected to have a material effect on our consolidated financial statements.

On August 27, 2014, the FASB issued ASU No. 2014-15, Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern.



## Table of Contents

The new guidance requires management of public and private companies to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern and, if so, disclose that fact. Management will also be required to evaluate and disclose whether its plans alleviate that doubt. The standard will be effective for our annual period ending December 31, 2016 and interim and annual periods thereafter. Early adoption is permitted. We do not expect that the requirement will have an impact on our financial position, results of operations or cash flows.

On May 28, 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard is effective for our annual and interim reporting periods beginning January 1, 2017. Early adoption is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. We are evaluating the effect that ASU 2014-09 will have on our consolidated financial statements and related disclosures. We have not yet selected a transition method nor have we determined the effect of the standard on our ongoing financial reporting.

### Off Balance Sheet Arrangements

As of December March 31, 2015, we did not have any off balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K, such as the use of unconsolidated subsidiaries, structured finance, special purpose entities or variable interest entities.

### Contractual Obligations

Our principal commitments consist of obligations under operating lease agreements for offices, research and development, and sales and marketing facilities, and agreements with third parties to provide co-location hosting and telecommunication usage services. These commitments as of December 31, 2014 are disclosed in our Annual Report on Form 10-K for the year ended December 31, 2014, and did not change during the three months ended March 31, 2015 except for the acquisition of certain additional data center and network equipment and software under multiple capital leases. As of March 31, 2015, total minimum future payment commitments under these capital leases were approximately \$1.7 million, of which \$0.4 million is due in 2015, with the remainder due over approximately 2.3 years thereafter.

### ITEM 3. Quantitative and Qualitative Disclosure about Market Risk

We are exposed to market risk in the ordinary course of our business. Market risk represents the risk of loss that may impact our financial position due to adverse changes in financial market prices and rates. Our market risk exposure is primarily a result of fluctuations in interest rates, and to a lesser extent, foreign currency exchange rates. We do not hold or issue financial instruments for trading purposes.

#### Interest Rate Sensitivity

As of March 31, 2015, we had cash of \$50.6 million and short-term investments of \$20.0 million. We hold our cash and short-term investments for working capital purposes. Declines in interest rates would reduce future interest income. For the three months ended March 31, 2015, the effect of a hypothetical 10% increase or decrease in overall interest rates would not have had a material impact on our interest income. The carrying amount of our short-term investments reasonably approximates fair value. We do not enter into investments for trading or speculative purposes. Our investments are exposed to market risk due to a fluctuation in interest rates, which may affect the fair market value of our investments. Due to the short-term nature of our investment portfolio, we believe only dramatic fluctuations in interest rates would have a material effect on our investments.

As of March 31, 2015, we had a total of \$36.5 million outstanding under our variable interest rate debt or financing agreements. See Note 6 of the notes to our condensed consolidated financial statements for a detailed discussion of our indebtedness. For the three months ended March 31, 2015, a hypothetical 10% increase in the interest rates under these agreements would have increased our interest expense by approximately \$0.1 million.

#### Foreign Currency Risk

The functional currency of our foreign subsidiaries is the U.S. dollar. All of our sales are denominated in U.S. dollars, and therefore our net revenue is not currently subject to foreign currency risk. Our operating expenses are primarily denominated in the currencies of the countries in which our operations are located, which are primarily in the U.S., the Philippines, Russia, and the U.K. Our consolidated results of operations and cash flows are, therefore,





Table of Contents

subject to fluctuations due to changes in foreign currency exchange rates and may be adversely affected in the future due to changes in foreign exchange rates. To date, we have not entered into any hedging arrangements with respect to foreign currency risk or other derivative financial instruments. During the three months ended March 31, 2015, the effect of a hypothetical 10% change in foreign currency exchange rates applicable to our business would have had a maximum impact of approximately \$0.1 million on our operating results.

ITEM 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, as of March 31, 2015.

Based on management's evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of March 31, 2015, our disclosure controls and procedures were designed, and were effective, to provide assurance at a reasonable level that the information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms, and that such information is accumulated and communicated to our management as appropriate to allow timely decisions regarding required disclosures.

In designing and evaluating our disclosure controls and procedures, management recognizes that any disclosure controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Changes in Internal Control over Financial Reporting

During the three months ended March 31, 2015, there was no change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

We are subject to certain legal and regulatory proceedings described below, and from time to time may be involved in a variety of claims, lawsuits, investigations and proceedings relating to contractual disputes, intellectual property rights, employment matters, regulatory compliance matters and other litigation matters.

Universal Services Fund Liability

During the third quarter of 2012, we determined that based on our business activities, we are classified as a telecommunications service provider for regulatory purposes and we are required to make direct contributions to the USF based on revenue we receive from the resale of interstate and international telecommunications services. Previously, we had been advised that the telecommunications services were an integral part of an information service and accordingly made indirect USF contributions as an end user through payments to our wholesale telecommunications service providers. In order to comply with the obligation to make direct contributions, in November 2012, we made a voluntary self-disclosure to the FCC Enforcement Bureau and have registered with USAC, which is charged by the FCC with administering the USF. We have accrued for past due contributions dating back to 2003 and, in April 2013, began remitting required contributions on a current basis directly to USAC. See Note 10 of the notes to our condensed consolidated financial statements for a discussion.

Our registration with USAC subjects us to assessments for unpaid USF contributions, as well as interest thereon and civil penalties, due to our late registration and past failure to recognize our obligation as a USF contributor and as an international carrier.

In 2012, we also determined that we were a provider of international telecommunications services and therefore we were required to secure from the FCC a section 214 international carrier authorization permitting such international telecommunications. We applied with the FCC for international carrier authority and also applied for, and received, special temporary authority ("STA") to continue to provide international telecommunications services while our international carrier application remains pending before the FCC. Our STA has since been renewed on three occasions and may be renewed again before the international authorization is granted.

In October 2014, the FCC Enforcement Bureau began to negotiate with us a consent decree and a civil penalty to conclude its investigation into our 2008 - 2012 USF contribution and international carrier authorization compliance. The amount of the civil penalty has been tentatively set at \$2.0 million. The terms of the consent decree have been tentatively negotiated and it is likely to be adopted in the course of 2015. The draft consent decree requires us to adopt certain internal regulatory compliance monitoring and training requirements, and to report on the status of those compliance efforts to the FCC's Enforcement Bureau during a period of three years. See Note 10 of the notes to our condensed consolidated financial statements for a discussion.

NobelBiz Litigation

On August 5, 2011, NobelBiz, Inc., or NobelBiz, sent a letter to us asserting infringement of a patent related to virtual call centers. On April 3, 2012, NobelBiz filed a patent infringement lawsuit against us in the United States District Court for the Eastern District of Texas. The patent asserted in the complaint is different, but related, to the patent asserted in the original letter. The lawsuit, NobelBiz Inc. v. Five9, Inc., Case No. 6:12-cv-00243-LED, alleges that our local caller ID management service infringes United States Patent No. 8,135,122, or the '122 patent. The '122 patent, titled "System and Method for Modifying Communication Information (MCI)," issued on March 13, 2012, and according to the complaint is alleged to relate to "a system for processing a telephone call from a call originator (also referred to as a calling party) to a call target (also referred to as a receiving party), where the system accesses a database storing outgoing telephone numbers, selects a replacement telephone number from the outgoing telephone numbers based on the telephone number of the call target, and originates an outbound call to the call target with a modified outgoing caller identification ('caller ID'). NobelBiz seeks damages in the form of lost profits as well as injunctive relief. The lawsuit is one of several lawsuits filed by NobelBiz the same day against various companies including TCN Inc., LiveVox, Inc. and Global Connect LLC. On March 28, 2013, the court granted our motion to transfer the case to the United States District Court for the Northern District of California. Subsequently, NobelBiz amended its complaint to add claims related to U.S. Patent No. 8,565,399, or the '399 patent, which is a continuation in the same family as the '122 patent and addresses the same technology. We responded to the complaint and amended

complaint by asserting noninfringement and invalidity of the '122 and '399 patents. On January 16, 2015, the court issued an order regarding claim construction of the two patents-in-suit, and on April 6,

Table of Contents

2015, the court held a case management conference setting further dates in the case. The Court set a trial date of June 20, 2016, and set a date for the Company to file motions for summary judgment by February 16, 2016.

**UHC Claim**

On January 29, 2015, Soneet Kapila, the Chapter 11 Trustee for the estate of Universal Health Care Group, Inc., which entity serves as the sole member of American Managed Care, LLC (“AMC”), filed an adversary complaint against us in the United States Bankruptcy Court for the Middle District of Florida. The adversary proceeding, *Soneet Kapila v. Five9, Inc.*, Case No. 13-05952 (KRM), Adv. No. 15-00092 (KRM), sought to avoid and recover as preferential payments, actual fraudulent transfers and/or constructive fraudulent transfers certain payments that we allegedly received from AMC in return for services provided by us between May 3, 2011 and May 3, 2014. The complaint sought approximately \$2.5 million in damages. The matter has been settled, with Bankruptcy Court approval, for a cash payment by us of \$99,000.

The outcome of litigation and regulatory claims cannot be predicted with certainty, may be expensive and cause distraction to our management, even if we are ultimately successful, and could harm our future results of operations, cash flows and financial condition.

**ITEM 1A. Risk Factors**

Our operations and financial results are subject to various risks and uncertainties. You should consider carefully the risks and uncertainties described below, together with all of the other information in this report. If any of the following risks or other risks actually occur, our business, financial condition, results of operations, and future prospects could be materially harmed, and the price of our common stock could decline.

The following description of the risk factors associated with our business includes any material changes to and supersedes the description of the risk factors associated with our business previously disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2014.

**Risks Related to Our Business and Industry**

Our quarterly and annual results may fluctuate significantly, may not fully reflect the underlying performance of our business and may result in decreases in the price of our common stock.

Our quarterly and annual results of operations, including our revenues, profitability and cash flow, may vary significantly in the future and period-to-period comparisons of our operating results may not be meaningful.

Accordingly, the results of any one quarter or period should not be relied upon as an indication of future performance.

Our quarterly and annual financial results may fluctuate as a result of a variety of factors, many of which are outside our control and, as a result, may not fully reflect the underlying performance of our business. Fluctuation in quarterly and annual results may harm the value of our common stock. Factors that may cause fluctuations in our quarterly and annual results include, without limitation:

- market acceptance of our solution;
- our ability to attract new clients and grow our business with existing clients;
- client renewal rates;
- changes in strategic and client relationships;
- the timing and success of new product and feature introductions by us or our competitors or any other change in the competitive dynamics of our industry, including consolidation among competitors, clients or strategic partners;
- network outages or security breaches, which may result in the loss of clients, client credits and harm to our reputation;
- seasonal factors that may cause our revenues in the first half of a year to be relatively lower than our revenues in the second half of a year, which we believe are due to the general increase in customer support and marketing and sales activities leading up to, and during, the holiday season;
- inaccessibility or failure of our cloud contact center software due to failures in the products or services provided by third parties;
- the timing of recognition of revenues;

Table of Contents

the amount and timing of costs and expenses related to the maintenance and expansion of our business, operations and infrastructure;

- increases or decreases in the elements of our solution or pricing changes upon any renewals of client agreements;
- changes in our pricing policies or those of our competitors;
- the level of professional services and support we provide our clients;
- the components of our revenue;
- the addition or loss of key clients, including through acquisitions or consolidations;
- general economic, industry and market conditions;
- the timing of costs and expenses related to the development or acquisition of technologies or businesses and potential future charges for impairment of goodwill from acquired companies;
- compliance with, or changes in, the current and future regulatory environment;
- the hiring, training and retention of key employees;
- litigation or other claims against us;
- our ability to obtain additional financing; and
- advances and trends in new technologies and industry standards.

If we are unable to attract new clients or sell additional services and functionality to our existing clients, our revenue and revenue growth will be harmed.

To increase our revenue, we must add new clients, add additional agent seats and sell additional functionality to existing clients, and encourage existing clients to renew their subscriptions on terms favorable to us. As our industry matures, as our clients experience seasonal trends in their business, or as competitors introduce lower cost and/or differentiated products or services that are perceived to compete favorably with ours, our ability to add new clients and renew, maintain or upsell existing clients based on pricing, technology and functionality could be impaired. As a result, we may be unable to renew our agreements with existing clients, attract new clients or grow or maintain our business from existing clients, which could harm our revenue and growth.

A portion of our revenue is generated by acquiring domestic and international telecommunications minutes from wholesale telecommunication service providers and reselling those minutes to our clients. We must resell more minutes if telecommunications rates decrease to maintain our level of usage revenue.

Our recent rapid growth may not be indicative of our future growth, and if we continue to grow rapidly, we may fail to manage our growth effectively.

For the three months ended March 31, 2015, our revenue was \$30.3 million, which increased by \$6.0 million, or 25%, from \$24.3 million for the same period of 2014. For the years ended December 31, 2014, 2013 and 2012, our revenue was \$103.1 million, \$84.1 million and \$63.8 million, respectively, representing year-over-year growth of 23% and 32%, respectively. We expect that, in the future, as our revenue increases, our annual revenue growth rate may continue to decline. We believe growth of our revenue depends on a number of factors, including our ability to:

- compete with other vendors of cloud-based enterprise contact center systems to capture market share from providers of legacy on-premise systems;
- increase our existing clients' use of our solution and further develop our partner ecosystem;
- introduce our solution to new markets outside of the United States and increase global awareness of our brand;
- strengthen and improve our solution through significant investments in research and development; and
- selectively pursue acquisitions.

If we are not successful in achieving these objectives, our revenue may be harmed. In addition, we plan to continue our investment in future growth, including expending substantial financial and other resources on:

- sales and marketing, including a significant expansion of our sales organization;
- our technology infrastructure, including systems architecture, management tools, scalability, availability, performance and security, as well as disaster recovery measures;

Table of Contents

• solution development, including investments in our solution development team and the development of new applications and features for existing solutions;  
• international expansion; and  
• general administration, including legal, regulatory compliance and accounting expenses.

Moreover, we have recently experienced a period of rapid growth in our headcount and operations. We grew from 442 employees as of December 31, 2012 to 635 employees as of March 31, 2015. We have also significantly increased the size of our client base to over 2,000 clients. We anticipate that we will continue to significantly expand our operations and headcount in the near term. This growth has placed, and future growth will place, a significant strain on our management, administrative, operational and financial infrastructure. Our success will depend in part on our ability to manage this growth effectively. To manage the expected growth of our operations and personnel, we will need to continue to improve our operational, financial and management controls and our reporting systems and procedures. Failure to effectively manage growth could result in difficulty or delays in adding new clients, declines in quality or client satisfaction, increases in costs, system failures, difficulties in introducing new features or solutions or other operational difficulties, and any of these difficulties could harm our business performance and results of operations. The expected addition of new employees and the capital investments that we anticipate will be necessary to manage our anticipated growth will make it more difficult for us to generate earnings or offset any future revenue shortfalls by reducing costs and expenses in the short term. If we fail to manage our anticipated growth, we will be unable to execute our business plan successfully.

The markets in which we participate are highly competitive, and if we do not compete effectively, our operating results could be harmed.

The market for contact center solutions is highly competitive. Generally, we do not have long-term contracts with our clients and our clients can terminate our service and switch to competitors' offerings on short notice.

We currently compete with large legacy technology vendors that offer on-premise enterprise telephony and contact center systems, such as Avaya and Cisco, and legacy on-premise software companies that come from a CTI heritage, such as Aspect, Genesys, and Interactive Intelligence. These companies are supplementing their traditional on-premise contact center systems with cloud offerings, either through acquisition or in-house development. Additionally, we compete with vendors that historically provided other contact center services and technologies and expanded to offer cloud contact center software. These companies include inContact and LiveOps. We also face competition from smaller contact center service providers with specialized contact center software offerings. Our actual and potential competitors may enjoy competitive advantages over us, including greater name recognition, longer operating histories and larger marketing budgets, as well as greater financial or technical resources. With the introduction of new technologies and market entrants, we expect competition to intensify in the future.

Some of our competitors can devote significantly greater resources than we can to the development, promotion and sale of their products and services and many have the ability to initiate or withstand substantial price competition. Current or potential competitors may also be acquired by third parties with significantly greater resources. In addition, many of our competitors have stronger name recognition, longer operating histories, established relationships with clients, more comprehensive product offerings, larger installed bases and major distribution agreements with consultants, system integrators and resellers. Our competitors may also establish cooperative relationships among themselves or with third parties that may further enhance their product offerings or resources. If our competitors' products, services or technologies become more accepted than our solution, if they are successful in bringing their products or services to market earlier than ours, or if their products or services are less expensive or more technologically capable than ours, our revenues could be harmed. Pricing pressures and increased competition could result in reduced sales, reduced margins and loss of, or a failure to maintain or improve, our competitive market position, any of which could harm our business.

If we fail to manage our technical operations infrastructure, our existing clients may experience service outages, our new clients may experience delays in the deployment of our solution and we could be subject to, among other things, claims for credits or damages.

Our success depends in large part upon the capacity, stability and performance of our operations infrastructure. From time to time, we have experienced interruptions in service, and may experience such interruptions in the future. These

service interruptions may be caused by a variety of factors, including infrastructure changes, human or software errors, viruses, security attacks, fraud, spikes in client usage and denial of service

34

---



Table of Contents

issues. In some instances, we may not be able to identify the cause or causes of these performance problems within an acceptable period of time. Our failure to achieve or maintain expected performance levels, stability and security could harm our relationships with our clients, result in claims for credits or damages, damage our reputation and significantly reduce client demand for our solution and harm our business.

Any future service interruptions could:

- cause our clients to seek credits or damages for losses incurred;
- cause existing clients to cancel or elect not to renew their contracts;
- affect our reputation as a reliable service provider;
- make it more difficult for us to attract new clients or expand our business with existing clients; or
- require us to replace existing equipment.

We have experienced significant growth in the number of agents and interactions that our infrastructure supports. As our client base grows and their use of our service increases, we will be required to make additional investments in our capacity to maintain adequate stability and performance, the availability of which may be limited or the cost of which may be prohibitive. In addition, we need to properly manage our operations infrastructure in order to support version control, changes in hardware and software parameters and the evolution of our solution. If we do not accurately predict or improve our infrastructure requirements to keep pace with growth in our business, our business could be harmed.

If our existing clients terminate their subscriptions or reduce their subscriptions and related usage, our revenues and gross margins will be harmed and we will be required to spend more money to grow our client base.

We expect to continue to derive a significant portion of our revenues from existing clients. As a result, retaining our existing clients is critical to our future operating results. We offer monthly, annual and multiple-year contracts to our clients, with 30 days' notice generally required for changes in the number of agent seats or termination of their contracts. In addition, the subscriptions and related usage by our existing clients may decrease if:

- the volume of minutes for inbound and outbound interactions between our clients and their customers decreases,
- clients are not satisfied with our services, prices or the functionality of our solution,
- the stability, performance and security of our hosting infrastructure and hosting services are not satisfactory,
- our clients' business declines due to industry cycles, seasonality, business difficulties or for other reasons,
- competition increases from other contact center providers,
- alternative technologies emerge which we do not provide,
- clients experience financial difficulties, or
- the U.S. or global economy declines.

If our existing clients' subscriptions and related usage decrease or are terminated, we will need to spend more money to acquire new clients to maintain our existing level of revenues. We incur significant costs and expenses, including sales and marketing expenses, to acquire new clients, and those costs and expenses are an important factor in determining our net profitability. There can be no assurance that the market for our solution will continue to grow or that we will not lose market share to current or future competitors.

The loss of one or more of our key clients, or a failure to renew our subscription agreements with one or more of our key clients, could harm our ability to market our solution.

We rely on our reputation and recommendations from key clients in order to market and sell our solution. The loss of any of our key clients, or a failure of some of them to renew or to continue to recommend our solution, could have a significant impact on our revenues, reputation and our ability to obtain new clients. In addition, acquisitions of our clients could lead to cancellation of our contracts with those clients or by the acquiring companies, thereby reducing the number of our existing and potential clients.

Table of Contents

Our growth depends in part on the success of our strategic relationships with third parties and our failure to successfully grow and manage these relationships could harm our business.

We leverage strategic relationships with third parties, such as CRM, system integrator, technology and telephony providers. For example, our CRM and system integrator relationships provide significant lead generation for new client opportunities. As we grow our business, we will continue to depend on both existing and new strategic relationships. Our competitors may be more successful than we are in establishing relationships with third parties or may provide incentives to third parties to favor their products over our solution. These strategic partners may cease to recommend our solutions to prospective clients due to actual or perceived lack of features, technological issues or failures, reputational concerns or other factors, which would harm our business, financial conditions and operations. Furthermore, if our partners are acquired, fail to work effectively with us or go out of business, they may no longer support or promote our solution, or may be less effective in doing so, which could harm our business, financial condition and operations. If we are unsuccessful in establishing or maintaining our strategic relationships with third parties, or these partners fail to recommend our solutions, our ability to compete in the marketplace or to grow our revenues could be impaired and our operating results may suffer. Even if we are successful, we cannot assure you that these relationships will result in increased client usage of our solution or increased revenue.

In addition, identifying new partners, and negotiating and documenting relationships with them, requires significant time and resources. As the complexity of our solution and our third-party relationships increases, the management of those relationships and the negotiation of contractual terms sufficient to protect our rights and limit our potential liabilities will become more complicated. We also license technology from certain third-party partners. Certain of these license agreements permit either party to terminate all or a portion of the license without cause at any time. Our inability to successfully manage these complex relationships or negotiate sufficient contractual terms could harm our business.

Our clients may fail to comply with the terms of their agreements, necessitating action by us to collect payment, or may terminate their subscriptions for our solution.

If clients fail to pay us under the terms of our agreements or fail to comply with the terms of our agreements, including compliance with regulatory requirements, we may terminate clients, lose revenue, be unable to collect amounts due to us, be subject to legal or regulatory action and incur costs in enforcing the terms of our contracts, including litigation. Some of our clients may seek bankruptcy protection or other similar relief and fail to pay amounts due to us, or pay those amounts more slowly, either of which could harm our operating results, financial position and cash flow.

We sell our solution to larger organizations that require longer sales and implementation cycles and often demand more configuration and integration services or customized features and functions that we may not offer, any of which could delay or prevent these sales and harm our growth rates, business and operating results.

As we target our sales efforts at larger organizations, we face greater costs, longer sales and implementation cycles and less predictability in completing our sales. These larger organizations typically require more configuration and integration services, which increases our upfront investment in sales and deployment efforts, with no guarantee that these clients will subscribe to our solution or increase the scope of their subscription. Furthermore, with larger organizations, we must provide greater levels of education regarding the use and benefits of our solution to a broader group of people. As a result of these factors, we must devote a significant amount of sales support and professional services resources to individual clients and prospective clients, thereby increasing the cost and time required to complete sales. Our typical sales cycle for larger organizations is four to five months, but can be significantly longer, and we expect that our average sales cycle may increase as sales to larger organizations continue to grow as a percentage of our business. Longer sales cycles could cause our operating and financial results to be less predictable and to fluctuate from period to period. In addition, many of our clients that are larger organizations initially deploy our solution to support only a portion of their contact center agents. Our success depends on our ability to increase the number of agent seats and the number of applications utilized by larger organizations over time. There is no guarantee that these clients will increase their subscriptions for our solution. If we do not expand our initial relationships with larger organizations, the return on our investments in sales and deployment efforts for these clients will decrease and our business may suffer.

Furthermore, we may not be able to provide the configuration and integration services that larger organizations typically require. For example, our solution does not currently permit clients to modify our code, but instead requires them to use our set of APIs. If prospective clients require customized features or functions that we

Table of Contents

do not offer, and that would be difficult for them to deploy themselves, they will need to leverage our services or we may lose sales opportunities with larger organizations and our business could suffer.

Because a significant percentage of our revenue is derived from existing clients, downturns or upturns in new sales will not be immediately reflected in our operating results and may be difficult to discern.

We generally recognize subscription revenue from clients monthly as services are delivered. As a result, a significant percentage of the subscription revenue we report in each quarter is derived from existing clients. Consequently, a decline in new subscriptions in any single quarter will likely have only a small impact on our revenue results for that quarter. However, the cumulative impact of such declines could harm our revenues in future quarters. Accordingly, the effect of significant downturns in sales and market acceptance of our solution, and potential changes in our pricing policies or renewal rates, will typically not be reflected in our results of operations until future periods. We also may be unable to adjust our cost structure to reflect the changes in revenue, resulting in lower margins and earnings. In addition, our subscription model makes it difficult for us to rapidly increase our revenue through additional sales in any period, as revenue from new clients will be recognized over time as services are delivered. For example, many of our clients initially deploy our solution to support only a portion of their contact center agents. Any increase to our revenue and the value of these existing client relationships will only be reflected in our results of operations as these clients increase the number of agent seats and the number of applications utilized with our solution over time as they experience the benefits of our cloud solution.

We rely on third-party telecommunications and internet service providers to provide our clients and their customers with telecommunication services and connectivity to our cloud contact center software and any failure by these service providers to provide reliable services could subject us to, among other things, claims for credits or damages.

We rely on third-party telecommunication service providers to provide our clients and their customers with telecommunication services. These telephony services include the public switched telephone network, or PSTN, telephone numbers, call termination and origination services, and local number portability for our clients. In addition, we depend on our internet bandwidth suppliers to provide uninterrupted and error-free service through their telecommunications networks. We exercise little control over these third-party providers, which increases our vulnerability to problems with the services they provide. If any of these service providers fail to provide reliable services, or terminate or increase the cost of the services that we and our clients depend on, we may be required to switch to another service provider. Delays caused by switching our technology to another service provider, if available, and qualifying this new service provider could materially harm our client relationships, business, financial condition and operating results.

Due to our reliance on these service providers, when problems occur, it may be difficult to identify the source of the problem. Service disruption or outages, whether caused by our service, the products or services of our third-party service providers, or our clients' or their customers' equipment and systems, may result in loss of market acceptance of our solution and any necessary repairs or other remedial actions may force us to incur significant costs and expenses. Any failure on the part of third-party service providers to achieve or maintain expected performance levels, stability and security could harm our relationships with our clients, result in claims for credits or damages, damage our reputation, significantly reduce client demand for our solution and seriously harm our financial condition and operating results.

We have a history of losses and we may be unable to achieve or sustain profitability.

We have incurred significant losses in each period since our inception in 2001. We incurred net losses of \$8.9 million and \$8.3 million in the three months ended March 31, 2015 and 2014, respectively, and a net loss of \$37.8 million in the year ended December 31, 2014. As of March 31, 2015, we had an accumulated deficit of \$137.5 million. These losses and our accumulated deficit reflect the substantial investments we have made to develop our solution and acquire new clients. We expect the dollar amount of our costs and expenses to increase in the future as revenue increases, although at a slower rate. We expect our losses to continue for the foreseeable future as we continue to develop and expand our business. Furthermore, to the extent we are successful in increasing our client base, we may also incur increased losses because costs associated with acquiring clients are generally incurred up front, while revenues are recognized over the course of the client relationship. Historically, we also have experienced negative gross margins on our professional services, which are expected to continue in the future. In addition, as a

public company, we incur significant legal, accounting and other expenses. You should not consider our recent growth in revenues as necessarily indicative of our future performance. Accordingly, we cannot assure you that we will achieve profitability in the future nor that, if we do become profitable, we will sustain profitability.

Table of Contents

If the market for cloud contact center software solutions develops more slowly than we expect or declines, our business could be harmed.

The cloud contact center software solutions market is not as mature as the market for legacy on-premise contact center systems, and it is uncertain whether cloud contact center solutions will achieve and sustain high levels of client demand and market acceptance. Our success will depend to a substantial extent on the widespread adoption of cloud contact center software solutions as a replacement for legacy on-premise systems. Many larger organizations have invested substantial technical, personnel and financial resources to integrate legacy on-premise contact center systems into their businesses and, therefore, may be reluctant or unwilling to migrate to cloud contact center solutions such as ours. It is difficult to predict client adoption rates and demand for our solution, the future growth rate and size of the cloud contact center software market, or the entry of competitive products and services. The expansion of the cloud contact center software solutions market depends on a number of factors, including the refresh rate for legacy on-premise systems, cost, performance and perceived value associated with cloud contact center software solutions, as well as the ability of providers of cloud contact center software solutions to address security, stability and privacy concerns. If other cloud contact center solution providers experience security incidents, loss of client data, disruptions in delivery or other problems, the market for cloud contact center software products, solutions and services as a whole, including our solution, may be harmed. If cloud contact center software solutions do not achieve widespread adoption, or there is a reduction in demand for such solutions caused by a lack of client acceptance, enhanced product offerings from on-premise providers, technological challenges, weakening economic conditions, security or privacy concerns, competing technologies and products, decreases in corporate spending or otherwise, it could result in decreased revenues and our business could be harmed.

Shifts over time or from quarter-to-quarter in the mix of sizes or types of organizations that purchase our solution or changes in the components of our solution purchased by our clients could affect our gross margin and operating results.

Our strategy is to sell our solution to both smaller and larger organizations. Our gross margins can vary depending on numerous factors related to the implementation and use of our solution, including the features and number of agent seats purchased by our clients and the level of usage and professional services and support required by our clients. For example, our larger clients typically require more professional services and because our professional services offerings typically have negative margins, any increase in sales of professional services could harm our gross margins and operating results. Sales to larger organizations may also entail longer sales cycles and more significant selling efforts. Selling to smaller clients may involve smaller contract sizes, fewer upsell opportunities, a higher likelihood of contract terminations, a reduction in agent seats and greater credit risk and uncertainty. If the mix of organizations that purchase our solution, or the mix of solution components purchased by our clients, changes unfavorably, our revenues and gross margins could decrease and our operating results could be harmed.

We depend on data centers operated by third parties and any disruption in the operation of these facilities could harm our business.

We host our solution at data centers located in Santa Clara, California; Atlanta, Georgia and Slough, England. Any failure or downtime in one of our data center facilities in the U.S. could affect a significant percentage of our clients. While we control and have access to our servers and all of the components of our network that are located in our external data centers, we do not control the operation of these facilities. The owners of our data center facilities have no obligation to renew their agreements with us on commercially reasonable terms, or at all. If we are unable to renew these agreements on commercially reasonable terms, or if one of our data center operators is acquired, closes, suffers financial difficulty or is unable to meet our growing capacity needs, we may be required to transfer our servers and other infrastructure to new data center facilities, and we may incur significant costs and service interruptions in connection with doing so.

Our data centers are subject to various points of failure. Problems with cooling equipment, generators, uninterruptible power supply, routers, switches, or other equipment, whether or not within our control, could result in service interruptions for our clients as well as equipment damage. Our data centers are subject to disasters such as earthquakes, floods, fires, hurricanes, acts of terrorism, sabotage, break-ins, acts of vandalism and other events, which could cause service interruptions or the operators of these data centers to close their facilities for an extended period of

time or permanently. The destruction or impairment of any of our data center facilities could result in significant downtime for our solution and the loss of client data. Because our ability to attract and retain clients depends on our providing clients with highly reliable service, even minor interruptions in our service could harm our business, revenues and reputation. Additionally, in connection with the continuing expansion of our existing data

Table of Contents

center facilities, there is an increased risk that service interruptions may occur as a result of server addition, relocation or other issues.

In addition, our data centers are subject to increased costs of power. We may not be able to pass on any increase in costs of energy to our clients, which could reduce our operating margins.

Our limited operating history makes it difficult to evaluate and predict our current business and future prospects. We have been in existence since 2001, and much of our growth has occurred in recent periods. Our limited operating history and recent growth may make it difficult for investors to evaluate our current business and our future prospects. We have encountered and will continue to encounter risks and difficulties frequently experienced by growing companies in rapidly changing industries, including increasing and unforeseen expenses as we continue to grow our business.

Our ability to forecast our future operating results is limited and subject to a number of uncertainties, including our ability to predict revenue levels, and plan for and model future growth. We have encountered and will continue to encounter risks and uncertainties frequently experienced by growing companies in rapidly changing industries, such as the risks and uncertainties described herein. If our assumptions regarding these risks and uncertainties, which we use to plan our business, are incorrect or change due to adjustments in our markets or our competitors and their product offerings, or if we do not address these risks successfully, our operating and financial results could differ materially from our expectations and our business could suffer.

If our solution fails, or is perceived to fail, to perform properly or if it contains technical defects, our reputation could be harmed, our market share may decline and we could be subject to product liability claims.

Our solution may contain undetected errors or defects that may result in failures or otherwise cause our solution to fail to perform in accordance with client expectations. Moreover, our clients could incorrectly implement or inadvertently misuse our products, which could result in their dissatisfaction and harm the perceived utility of our products as well as our brand. Because our clients use our solution for mission-critical aspects of their business, any real or perceived errors or defects in, or other performance problems with, our solution may damage our clients' businesses and could significantly harm our reputation. If that occurs, we could lose future sales, or our existing clients could elect to cancel or not renew our solution, seek payment credits or delay or withhold payment to us, which could result in reduced revenues, an increase in our provision for uncollectible accounts and service credits and an increase in collection cycles for accounts receivable. Clients also may make indemnification or warranty claims against us, which could result in significant expense and risk of litigation. Product performance problems could result in loss of market share, failure to achieve market acceptance and the diversion of development resources.

Any product liability, intellectual property, warranty or other claims against us could damage our reputation and relationships with our clients, and could require us to spend significant time and money in litigation or pay significant settlements or damages. Although we maintain general liability insurance, including coverage for errors and omissions, this coverage may not be sufficient to cover liabilities resulting from such claims. Also, our insurer may disclaim coverage. Our liability insurance also may not continue to be available to us on reasonable terms, in sufficient amounts, or at all. Any contract or product liability claims successfully brought against us would harm our business.

If our security measures are breached or unauthorized access to client data is otherwise obtained, our solution may be perceived as not being secure, clients may reduce the use of or stop using our solution and we may incur significant liabilities.

Our solution involves the storage and transmission of our clients' information, including information about our clients' customers or other information treated by our clients as confidential. Unauthorized access or other breaches in our security could result in the loss of confidentiality, integrity and availability of information, leading to litigation, indemnity obligations and other liability. While we have security measures in place to protect client information and minimize the probability of security breaches, if these measures fail as a result of a cyber-attack, other third-party action, employee error, malfeasance or otherwise, and someone obtains unauthorized access to our clients' data, our reputation could be damaged, our business may suffer and we could incur significant liability. Because the techniques used to obtain unauthorized access or sabotage systems change frequently and generally are not identified until they are launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative



measures. In addition, any failure on the part of third parties, including our clients, to achieve or maintain security measures for their own systems could harm our relationships with our clients, result

Table of Contents

in claims against us for credits or damages, damage our reputation and significantly reduce client demand for our solution. Any or all of these issues could harm our ability to attract new clients, cause existing clients to elect not to renew their subscriptions, result in reputational damage or subject us to third-party lawsuits, regulatory fines or other action or liability, all of which could harm our operating results.

We are subject to many hazards and operational risks that can disrupt our business, some of which may not be insured or fully covered by insurance.

Our operations are subject to many hazards inherent in the cloud contact center software business, including:

• damage to third-party and our infrastructure and data centers, related equipment and surrounding properties caused by earthquakes, hurricanes, tornadoes, floods, fires and other natural disasters, explosions and acts of terrorism;

• inadvertent damage from third parties; and

• other hazards that could also result in suspension of operations, personal injury and even loss of life.

These risks could result in substantial losses and the curtailment or suspension of our operations. For example, in the event of a major earthquake along the West Coast (where our corporate headquarters and one of our data centers are located), hurricane or tropical storm in the southeastern United States (where our other U.S. data center is located) or catastrophic events such as fire, power loss, telecommunications failure, cyber-attack, war or terrorist attack, we may be unable to continue our operations and may endure system and service interruptions, reputational harm, delays in product development, breaches of data security and loss of critical data, all of which could harm our business and operating results. In addition, since telecommunications billing is inherently complex and requires highly sophisticated information systems to administer, our billing system may experience errors or we may improperly operate the system, which could result in the system incorrectly calculating the fees owed by our customers for our services or related taxes and administrative fees.

We are not insured against all claims, events or accidents that might occur. If a significant accident or event occurs that is not fully insured, if we fail to recover all anticipated insurance proceeds for significant accidents or events for which we are insured, or if we or our data center providers fail to reopen facilities damaged by such accidents or events, our operations and financial condition could be harmed. In addition to being denied coverage under existing insurance policies, we may not be able to maintain or obtain insurance of the type and amount we desire at reasonable rates.

The contact center software solutions market is subject to rapid technological change, and we must develop and sell incremental and new products in order to maintain and grow our business.

The contact center software solutions market is characterized by rapid changes in client requirements, frequent introductions of new and enhanced products and continuing and rapid technological advancement. To compete successfully, we must continue to design, develop, manufacture and sell new and enhanced contact center products, applications and features that provide increasingly higher capabilities, performance and stability at lower cost. If we are unable to develop new features for our existing solution or new applications that achieve market acceptance or that keep pace with technological developments, our business would be harmed. For example, we are focused on enhancing the reliability, features and functionality of our contact center solution to enhance its utility to our clients, particularly larger clients with complex, dynamic and global operations. In June 2014, we introduced the latest version of our cloud contact center software, Summer Release 2014. This release includes new native multichannel applications that support social, mobile, chat and email interactions. The success of this product and other products and enhancements depends on many factors, including timely development, introduction and market acceptance, as well as our ability to transition our existing clients to these new products, applications and features. Failure in this regard may significantly impair our revenue growth. In addition, because our solution is designed to operate on a variety of systems, we will need to continuously modify and enhance our solution to keep pace with changes in hardware, operating systems, the increasing trend toward multi-channel communications and other changes to software technologies. We may not be successful in developing these modifications and enhancements or bringing them to market in a timely fashion. Furthermore, uncertainties about the timing and nature of new network platforms or technologies, or modifications to existing platforms or technologies, could delay introduction of our solution and increase our research and development expenses. Any failure of our solution to operate effectively with future network platforms and technologies could reduce the demand for our solution, result in client dissatisfaction and harm

our business.

40

---

Table of Contents

Our ability to continue to enhance our solution is dependent on adequate research and development resources. If we are not able to adequately fund our research and development efforts, we may not be able to compete effectively and our business and operating results may be harmed.

In order to remain competitive, we must continue to develop new solution offerings and enhancements to our existing cloud contact center software. Maintaining adequate research and development personnel and resources to meet the demands of the market is essential. If we are unable to develop products, applications or features internally due to certain constraints, such as high employee turnover, insufficient cash, inability to hire sufficient research and development personnel or a lack of other research and development resources, we may miss market opportunities. Furthermore, many of our competitors expend considerably greater amounts on their research and development programs, and those that do not may be acquired by larger companies that would allocate greater resources to our competitors' research and development programs. Our failure to devote adequate research and development resources or compete effectively with the research and development programs of our competitors could harm our business. If we are unable to maintain the compatibility of our software with other products and technologies, our business would be harmed.

Our clients often integrate our solution with their business applications, particularly third-party CRM solutions. These third-party providers or their partners could alter their products so that our solution no longer integrates well with them, or they could delay or deny our access to technology releases that allow us to adapt our solution to integrate with their products in a timely fashion. If we cannot adapt our solution to changes in complementary technology deployed by our clients, it may significantly impair our ability to compete effectively.

Our business could be harmed if our clients are not satisfied with the professional services and technical support provided by us or our partners.

Our business depends on our ability to satisfy our clients, not only with respect to our solution, but also with the professional services and technical support that are performed to enable our clients to implement and use our solution to address their business needs. Professional services and technical support may be performed by our own staff or, with respect to a select subset of our solution, by third parties. We may be unable to respond quickly enough to accommodate short-term increases in client demand for support services. We also may be unable to modify the format of our support services or change our pricing to compete with changes in support services provided by our competitors. Increased client demand for these services, without corresponding revenues, could increase our costs and harm our operating results. If a client is not satisfied with the deployment and ongoing services performed by us or a third party, then we could lose clients, miss opportunities to expand our business with these clients, incur additional costs, or lose, or suffer reduced margins on, our service revenue, any of which could damage our ability to grow our business. In addition, negative publicity related to our professional services and technical support, regardless of its accuracy, may further damage our business by affecting our ability to compete for new business with current and prospective clients.

Sales to clients outside the United States or with international operations and our international sales efforts and operations support expose us to risks inherent in international sales and operations.

A key element of our growth strategy is to expand our international sales efforts and develop a worldwide client base. Because of our limited experience with international sales efforts, our international expansion may not be successful and may not produce the return on investment we expect. To date, we have realized only a small portion of our revenues from clients outside the United States.

Our international employees are primarily located in the Philippines, where technical support, training and other professional services are performed, and Russia, where software development services are performed. In connection with our new data center in the U.K., we also commenced operations in the U.K. to maintain and support the data center and to provide service and support to clients in certain countries of the European Union. Operating in international markets requires significant resources and management attention and subjects us to intellectual property, regulatory, economic and political risks that are different from those in the United States. As we increase our international sales efforts and continue our other international operations, we will face risks in doing business internationally that could harm our business, including:

• the need to establish and protect our brand in international markets;

the need to localize and adapt our solution for specific countries, including translation into foreign languages and associated costs and expenses;

41

---

Table of Contents

- difficulties in staffing and managing foreign operations, particularly hiring and training qualified sales and service personnel;
- different pricing environments, longer sales and accounts receivable payment cycles and collections issues;
- new and different sources of competition;
- general economic conditions in international markets;
- fluctuations in the value of the U.S. dollar and foreign currencies, which may make our solution more expensive in other countries or may increase our costs, impacting our operating results when translated into U.S. dollars;
- compliance challenges related to the complexity of multiple, conflicting and changing governmental laws and regulations, including employment, tax, telecommunications and telemarketing laws and regulations;
- privacy and data protection laws and regulations that are complex, expensive to comply with and may require that client data be stored and processed in a designated territory;
- weaker protection for intellectual property and other legal rights than in the U.S. and practical difficulties in enforcing intellectual property and other rights outside of the U.S.;
- increased risk of international telecom fraud;
- laws and business practices favoring local competitors;
- compliance with U.S. laws and regulations for foreign operations, including the Foreign Corrupt Practices Act, the U.K. Bribery Act, import and export control laws, tariffs, trade barriers, economic sanctions and regulatory or contractual limitations on our ability to sell our solution in certain foreign markets, and the risks and costs of non-compliance;
- increased financial accounting and reporting burdens and complexities;
- restrictions on the transfer of funds;
- adverse tax consequences; and
- unstable economic and political conditions.

These risks could harm our international operations, increase our operating costs and hinder our ability to grow our international business and, consequently, our overall business and results of operations. In addition, if the political and military situation in Russia and the Ukraine significantly worsens, or if either Russia or the United States imposes significant new economic sanctions or restrictions, and we are restricted or precluded from continuing our software development operations in Russia, our costs could increase, and our product development efforts, business and results of operations could be significantly harmed.

In addition, compliance with laws and regulations applicable to our international operations increases our cost of doing business outside the United States. We may be unable to keep current with changes in foreign government requirements and laws as they change from time to time. Failure to comply with these regulations could harm our business. In many countries outside the United States it is common for others to engage in business practices that are prohibited by our internal policies and procedures or U.S. regulations applicable to us. Although we have implemented policies and procedures designed to ensure compliance with these laws and policies, there can be no assurance that all of our employees, contractors, strategic partners and agents will comply with these laws and policies. Violations of laws or key control policies by our employees, contractors, strategic partners or agents could result in delays in revenue recognition, financial reporting misstatements, fines, penalties, or prohibitions on selling our solution, any of which could harm our business.

We depend on our senior management team and the loss of one or more key employees or an inability to attract and retain highly skilled employees could harm our business and results of operations.

Our success largely depends upon the continued services of our key executive officers. We also rely on our leadership team in the areas of research and development, marketing, sales, services and general and administrative functions, and on mission-critical individual contributors. From time to time, there may be changes in our executive management team resulting from the hiring or departure of executives, which could disrupt our business. The loss of one or more of our executive officers or key employees could seriously harm our business. We currently do not maintain key person life insurance policies on any of our employees.

To execute our growth plan, we must attract and retain highly qualified personnel and we may incur significant costs to do so. Competition for these personnel is intense, especially for engineers with high levels of experience in designing and developing cloud software and for senior sales executives. We have, from time to time,

Table of Contents

experienced, and we expect to continue to experience, difficulty in hiring and retaining employees with appropriate qualifications. Many of the companies with which we compete for experienced personnel have greater resources than we have. If we hire employees from competitors or other companies, their former employers may attempt to assert that these employees or we have breached legal obligations, resulting in a diversion of our time and resources and, potentially, damages.

Volatility or lack of performance in the trading price of our common stock may also affect our ability to attract and retain qualified personnel because job candidates and existing employees often emphasize the value of the stock awards they receive in connection with their employment when considering whether to accept or continue employment. If the perceived value of our stock awards is low or declines, it may harm our ability to recruit and retain highly skilled employees.

In addition, we invest significant time and expense in training our employees, which increases their value to competitors who may seek to recruit them and increases our costs. If we fail to attract new personnel or fail to retain and motivate our current personnel, our business and future growth prospects would be harmed.

Failure to adequately expand our sales force will impede our growth.

We will need to continue to expand and optimize our sales infrastructure in order to grow our client base and our business. We plan to aggressively expand our sales force, both domestically and internationally. Identifying and recruiting qualified personnel and training them in the use and sale of our solution requires significant time, expense and attention. It can take several months before our sales representatives are fully trained and productive. Our business may be harmed if our efforts to expand and train our sales force do not generate a corresponding increase in revenues. In particular, if we are unable to hire, develop and retain talented sales personnel or if new sales personnel are unable to achieve desired productivity levels in a reasonable period of time, we may not be able to realize the expected benefits of this investment or increase our revenues.

If we fail to grow our marketing capabilities and develop widespread brand awareness cost effectively, our business may suffer.

Our ability to increase our client base and achieve broader market acceptance of our cloud contact center software solution will depend to a significant extent on our ability to expand our marketing operations. We plan to continue to dedicate significant resources to our marketing programs, including internet advertising, digital marketing campaigns, social marketing, trade shows, industry events, co-marketing with strategic partners and telemarketing. The effectiveness of our online advertising has varied over time and may vary in the future due to competition for key search terms, changes in search engine use and changes in the search algorithms used by major search engines. All of these efforts will continue to require us to invest significant financial and other resources in our marketing efforts. Our business will be seriously harmed if our efforts and expenditures do not generate a proportionate increase in revenue. In addition, we believe that developing and maintaining widespread awareness of our brand in a cost-effective manner, both in the United States and internationally, is critical to achieving widespread acceptance of our solution and attracting new clients. Brand promotion activities may not generate client awareness or increase revenues, and even if they do, any increase in revenues may not offset the costs and expenses we incur in building our brand. If we fail to successfully promote, maintain and protect our brand, or incur substantial costs and expenses, we may fail to attract or retain clients necessary to realize a sufficient return on our brand-building efforts, or to achieve the widespread brand awareness that is critical for broad client adoption of our solution.

We may not be able to secure additional financing on favorable terms, or at all, to meet our future capital needs. To date, we have financed our operations, primarily through sales of our solution, net proceeds from the issuance of convertible preferred stock, lease facilities and, more recently, net proceeds from our initial public offering, or IPO, and debt financings. We do not know when or if our operations will generate sufficient cash to fund our ongoing operations. In the future, we may require additional capital to respond to business opportunities, challenges, acquisitions, a decline in sales, increased regulatory obligations or unforeseen circumstances and may engage in equity or debt financings or enter into credit facilities.

We have a substantial amount of debt. As of March 31, 2015, we had \$20.0 million outstanding under a loan and security agreement for a term loan facility of up to \$30.0 million, \$16.5 million outstanding (comprised of \$12.5 million under the revolving line of credit and \$4.0 million outstanding under a term loan) under a loan and security





Table of Contents

agreement and \$2.4 million outstanding under a promissory note with the Universal Services Administration Company, or USAC. See Note 6 of the notes to condensed consolidated financial statements.

Our loan and security agreements are collateralized by substantially all of our assets and contain a number of covenants that limit our ability to, among other things, sell assets, make acquisitions or investments, incur debt, grant liens, pay dividends, enter into transactions with our affiliates and use all of our available cash on hand and may prevent us from engaging in acts that may be in our best long-term interests. The amount of our current debt and the collateral pledged under the loan and security agreements and the covenants to which we are bound may prevent us from being able to timely secure additional debt or equity financing on favorable terms, or at all, or to pursue business opportunities, including potential acquisitions. Any debt financing obtained by us in the future would cause us to incur additional debt service expenses and could include restrictive covenants relating to our capital raising activities and other financial and operational matters, which may make it more difficult for us to obtain additional capital and pursue business opportunities. If we raise additional funds through further issuances of equity or convertible debt securities, our existing stockholders could suffer significant dilution in their percentage ownership of our company, and any new equity securities we issue could have rights, preferences and privileges senior to those of holders of our common stock. If we are unable to obtain adequate financing or financing on terms satisfactory to us when we require it, our ability to continue to grow and support our business and to respond to business challenges could be significantly limited.

Adverse economic conditions may harm our business.

Our business depends on the overall demand for cloud contact center software solutions and on the economic health of our current and prospective clients. In general, worldwide economic conditions remain unstable. In addition to the United States, we plan to market and sell our solution in Europe, Asia and other international markets. If economic conditions in these areas and other key potential markets for our solution continue to remain uncertain or deteriorate further, many clients may delay or reduce their contact center and overall information technology spending. If our clients experience economic hardship, this could reduce the overall demand for our solution, delay and lengthen sales cycles, lower prices for our solution, and lead to slower growth or even a decline in our revenues, operating results and cash flows.

We may acquire other companies or technologies or be the target of strategic transactions, which could divert our management's attention, result in additional dilution to our stockholders and otherwise disrupt our operations and harm our operating results.

We may acquire or invest in businesses, applications or technologies that we believe could complement or expand our solution, enhance our technical capabilities or otherwise offer growth opportunities. The pursuit of potential acquisitions may divert the attention of management, and cause us to incur various costs and expenses in identifying, investigating and pursuing suitable acquisitions, whether or not they are consummated. We may not be able to identify desirable acquisition targets or be successful in entering into an agreement with any particular target.

To date, the growth in our business has been primarily organic, and we have limited experience in acquiring other businesses, having only completed one small acquisition. In any future acquisitions, we may not be able to successfully integrate acquired personnel, operations and technologies, or effectively manage the combined business following the acquisition. We also may not achieve the anticipated benefits from our future acquired businesses due to a number of factors, including:

- inability to integrate or benefit from acquisitions in a profitable manner;
- unanticipated costs or liabilities associated with the acquisition;
- incurrence of acquisition-related costs;
- difficulty converting the clients of the acquired business to our solution and contract terms, including disparities in the revenues, licensing, support or professional services model of the acquired company;
- difficulty integrating the accounting systems, operations and personnel of the acquired business;
- difficulties and additional costs and expenses associated with supporting legacy products and hosting infrastructure of the acquired business;
- diversion of management's attention from other business concerns;
- harm to our existing relationships with our partners and clients as a result of the acquisition;

the loss of our or the acquired business's key employees;  
diversion of resources that could have been more effectively deployed in other parts of our business; and

44

---

Table of Contents

use of substantial portions of our available cash to consummate the acquisition.

In addition, a significant portion of the purchase price of companies we acquire may be allocated to acquired goodwill and other intangible assets, which must be assessed for impairment at least annually. In the future, if our acquisitions do not yield expected returns, we may be required to take charges to our operating results based on this impairment assessment process, which could harm our results of operations.

Acquisitions could also result in dilutive issuances of equity securities, the use of our available cash, or the incurrence of debt, which could harm our operating results. In addition, if an acquired business fails to meet our expectations, our operating results, business and financial condition may suffer.

In addition, we sometimes receive inquiries relating to potential strategic transactions, including from third parties who may seek to acquire us. We will continue to consider and discuss such transactions as we deem appropriate.

If we are unable to further develop and maintain effective internal control over financial reporting, investors may lose confidence in the accuracy and completeness of our financial reports and the market price of our common stock may decrease.

As a public company, we are required to maintain internal control over financial reporting and to report any material weaknesses in such internal controls. Section 404 of the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act, requires that we evaluate and determine the effectiveness of our internal control over financial reporting and, beginning with our annual report for the year ending December 31, 2015, provide a management report on our internal control over financial reporting. However, our independent registered public accounting firm will not be required to formally attest to the effectiveness of our internal control over financial reporting pursuant to Section 404 until the later of the year ending December 31, 2015 or the date we are no longer an “emerging growth company,” as defined by The Jumpstart Our Businesses Act of 2012, or the JOBS Act.

We are still engaged in the costly and challenging process of compiling the system and processing documentation necessary to perform the evaluation needed to comply with Section 404. We may not be able to complete our evaluation, testing and any required remediation in a timely manner. During the evaluation and testing process, if we identify one or more material weaknesses in our internal control over financial reporting, we will be unable to assert that our internal controls are effective. For example, two material weaknesses were identified in our internal control over financial reporting in 2010, one of which was remediated in 2011 and the other of which was remediated in 2012. A “material weakness” is a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis.

If in the future we have material weaknesses in our internal control over financial reporting, we may not detect errors on a timely basis and our financial statements may be materially misstated. If we identify material weaknesses in our internal control over financial reporting, if we are unable to comply with the requirements of Section 404 in a timely manner, if we are unable to assert that our internal control over financial reporting is effective or if our independent registered public accounting firm is unable to attest that our internal control over financial reporting is effective, investors may lose confidence in the accuracy and completeness of our financial reports and the market price of our common stock could decrease. We could also become subject to stockholder or other third-party litigation as well as investigations by the stock exchange on which our securities are listed the SEC or other regulatory authorities, which could require additional financial and management resources and could result in fines, trading suspensions or other remedies.

Changes in financial accounting standards or practices may cause adverse, unexpected financial reporting fluctuations and affect our reported operating results.

Generally accepted accounting principles in the United States, or U.S. GAAP, are subject to interpretation by the Financial Accounting Standards Board, or FASB, the SEC and various bodies formed to promulgate and interpret appropriate accounting principles. A change in accounting standards or practices can have a significant effect on our reported results and may even affect our financial statements completed before the change is effective. New accounting pronouncements and varying interpretations of accounting pronouncements have occurred and will occur in the future. Changes to existing rules or the questioning of current practices may harm our reported financial results or the way we account for or conduct our business.

For example, we recognize revenue in accordance with ASU 2009-13, Revenue Recognition (Topic 605) — Multiple-Deliverable Revenue Arrangements — a Consensus of the Emerging Issues Task Force (formerly known as

45

---

## Table of Contents

EITF 08-01). In May 2014, the FASB issued ASU 2014-09 Revenue from Contracts with Customers, a new standard on the recognition of revenue from contracts with customers, which includes a single set of rules and criteria for revenue recognition to be used across all industries. Companies may use either a full retrospective or a modified retrospective approach to adopt ASU 2014-09. The new standard is effective for our annual and interim reporting periods beginning January 1, 2017. All companies that enter into contracts with customers to transfer goods or services will be affected in some way by ASU 2014-09. As a result of future interpretations or applications of existing and new accounting standards, including ASU 2014-09 and ASU 2009-13, the timing of our revenue recognition could change, which would cause fluctuations in our operating results.

In addition, certain factors have in the past and may in the future cause us to defer recognition of revenues. For example, the inclusion in our client contracts of material non-standard terms, such as acceptance criteria, could require the deferral of revenue. To the extent that such contracts become more prevalent in the future our revenue may be harmed.

Because of these factors and other specific requirements under U.S. GAAP for revenue recognition, we must have precise terms and conditions in our arrangements in order to recognize revenue when we deliver our solution or perform our professional services. Negotiation of mutually acceptable terms and conditions can extend our sales cycle, and we may accept terms and conditions that do not permit revenue recognition at the time of delivery.

We may not be able to utilize a significant portion of our net operating loss or research tax credit carryforwards, which could harm our profitability.

As of December 31, 2014, we had federal and state net operating loss carryforwards due to prior period losses of \$106.4 million and \$68.8 million, respectively, which if not utilized will begin to expire in 2024 for federal purposes and began to expire in 2014 for state purposes. We also have federal research tax credit carryforwards, which if not utilized will begin to expire in 2028. If we are unable to generate sufficient taxable income to utilize our net operating loss and research tax credit carryforwards, these carryforwards could expire unused and be unavailable to offset future income tax liabilities, which could harm our profitability.

In addition, under Section 382 of the Internal Revenue Code of 1986, as amended, or the Code, our ability to utilize net operating loss carryforwards or other tax attributes, such as research tax credits, in any taxable year may be limited if we experience an “ownership change.” A Section 382 “ownership change” generally occurs if one or more stockholders or groups of stockholders who own at least 5% of our stock increase their ownership by more than 50 percentage points over their lowest ownership percentage within a rolling three-year period. Similar rules may apply under state tax laws. Future issuances or sales of our stock (including certain transactions involving our stock that are outside of our control) could cause an “ownership change.” If an “ownership change” occurs, Section 382 would impose an annual limit on the amount of pre-ownership change net operating loss carryforwards and other tax attributes we can use to reduce our taxable income, potentially increasing and accelerating our liability for income taxes, and also potentially causing those tax attributes to expire unused. It is possible that such an ownership change could materially reduce our ability to use our net operating loss carryforwards or other tax attributes to offset taxable income, which could harm our profitability.

### Risks Related to Our Intellectual Property

Any failure to protect our intellectual property rights could impair our ability to protect our proprietary technology and our brand.

Our success and ability to compete depend in part upon our intellectual property. As of March 31, 2015, our intellectual property portfolio included twenty-five registered and two pending U.S. trademarks, seven issued U.S. patents, six pending U.S. patent applications and one registered U.S. copyright. Furthermore, as of March 31, 2015, we had eleven pending patent applications and limited trademark registrations outside the U.S. We primarily rely on copyright, trade secret and trademark laws, trade secret protection and confidentiality or license agreements with our employees, clients, partners and others to protect our intellectual property rights. However, the steps we take to protect our intellectual property rights may be inadequate. We may not be able to obtain any further patents or trademarks, and our pending applications may not result in the issuance of patents or trademarks. We have pending patent applications and limited trademark registrations outside the U.S., and we may have to expend significant resources to obtain additional protection as we expand our international operations. Furthermore, legal standards relating to the

validity, enforceability and scope of protection of intellectual property rights in other countries, including Russia, where we have significant research and development operations, are uncertain and may afford little or no effective protection of our proprietary technology. Consequently, we may be unable to prevent our

Table of Contents

proprietary technology from being exploited abroad, which could affect our ability to expand to international markets or require costly efforts to protect our technology.

In order to protect our intellectual property rights, we may be required to spend significant resources to monitor and protect these rights. Litigation brought to protect and enforce our intellectual property rights could be costly, time consuming and distracting to management and could result in the impairment or loss of our intellectual property. Furthermore, our efforts to enforce our intellectual property rights may be met with defenses, counterclaims and countersuits attacking the validity and enforceability of our intellectual property rights. Accordingly, we may not be able to prevent third parties from infringing upon or misappropriating our intellectual property. Our failure to secure, protect and enforce our intellectual property rights could substantially harm the value of our technology, solutions, brand and business.

We may continue to be subject to third-party intellectual property infringement claims.

There is considerable patent and other intellectual property development activity and litigation in our industry. Our success depends upon our not infringing upon the intellectual property rights of others. Our competitors, as well as a number of other entities and individuals, may own or claim to own intellectual property relating to our industry. From time to time, third parties have claimed that we are infringing upon their intellectual property rights. For example, on April 3, 2012, NobelBiz, Inc. filed a patent infringement lawsuit against us alleging that our local caller ID management service infringes United States Patent No. 8,135,122. Subsequently, NobelBiz amended its complaint to add claims related to U.S. Patent No. 8,565,399, which is a continuation in the same family as the prior patent and addresses the same technology. NobelBiz seeks damages in the form of lost profits as well as injunctive relief. See “Part II, Item 1 — Legal Proceedings.” If NobelBiz is successful in its request for injunctive relief, we will have to stop providing the accused technology, enter into a license agreement with NobelBiz for the technology or modify our technology, any of which could harm our business. There can be no assurance that we (i) will prevail in this action, (ii) can develop non-infringing technology that is accepted in the market if we are enjoined from using the accused technology or (iii) will be able to negotiate favorable licensing terms with NobelBiz. There can also be no assurance that other actions alleging infringement by us of third-party patents will not be asserted or prosecuted against us. Certain technology necessary for us to provide our solution may be patented or otherwise protected by other parties either now or in the future. In such case, we would have to negotiate a license for the use of that technology. We may not be able to negotiate such a license at a price that is acceptable, or at all. The existence of such a patent or other protections, or our inability to negotiate a license for any such technology on acceptable terms, could force us to cease using such technology and offering solutions incorporating such technology.

In the future, others may claim that our solution and underlying technology infringe or violate their intellectual property rights. However, we may be unaware of the intellectual property rights that others may claim cover some or all of our technology or solution. Any claims or litigation could cause us to incur significant costs and expenses and, if successfully asserted against us, could require that we pay substantial damages or ongoing royalty payments, require that we refrain from using, manufacturing or selling certain offerings or using certain processes, prevent us from offering our solution, or require that we comply with other unfavorable terms, any of which could harm our business and operating results. We may also be obligated to indemnify our clients or business partners or pay substantial settlement costs, including royalty payments, in connection with any such claim or litigation and to obtain licenses, modify applications, or refund fees, which could be costly. Even if we were to prevail in such a dispute, any litigation regarding our intellectual property could be costly and time consuming and divert the attention of our management and key personnel from our business operations.

We employ third-party licensed software for use in or with our solution, and the inability to maintain these licenses or errors in the software we license could result in increased costs, or reduced service levels, which could harm our business.

Our solution incorporates certain third-party software obtained under licenses from other companies. We anticipate that we will continue to rely on such third-party software and development tools from third parties in the future. Although we believe that there are commercially reasonable alternatives to the third-party software we currently license, this may not always be the case, or it may be difficult or costly to transition to other providers. In addition, integration of the software used in our solution with new third-party software may require significant work and require



substantial investment of our time and resources. To the extent that our solution depends upon the successful operation of third-party software in conjunction with our software, any undetected errors or defects in this third-party software could prevent the deployment or impair the functionality of our solution, delay new product or

Table of Contents

solution introductions, result in increased costs, or a failure of our solution and injure our reputation. Our use of additional or alternative third-party software would require us to enter into license agreements with third parties and to integrate such software to our solution.

There can be no assurance that the technology licensed by us will continue to provide competitive features and functionality or that licenses for technology currently utilized by us or other technology that we may seek to license in the future, will be available to us at a reasonable cost or on commercially reasonable terms, or at all. The loss of, or inability to maintain, existing licenses could result in implementation delays or reductions until equivalent technology or suitable alternative solutions could be developed, identified, licensed and integrated, and could harm our business. Our solution utilizes open source software, and any failure to comply with the terms of one or more of these open source licenses could negatively affect our business.

Our solution includes software covered by open source licenses, which may include, for example, free general public use licenses, open source front-end libraries, open source stand-alone applications and open source applications. The terms of various open source licenses have not been interpreted by United States courts, and there is a risk that such licenses could be construed in a manner that imposes unanticipated conditions or restrictions on our ability to market our solution. By the terms of certain open source licenses, we could be required to release the source code of our proprietary software, and to make our proprietary software available under open source licenses, if we combine our proprietary software with open source software in a certain manner. In the event that portions of our proprietary software are determined to be subject to an open source license, we could be required to publicly release the affected portions of our source code, re-engineer all or a portion of our technologies, or otherwise be limited in the licensing of our technologies, each of which could reduce or eliminate the value of our technologies and solutions. In addition to risks related to license requirements, usage of open source software can lead to greater risks than use of third-party commercial software, as open source licensors generally do not provide warranties or controls on the origin of the software. Given the nature of open source software, there is also a risk that third parties may assert copyright and other intellectual property infringement claims against us based on our use of certain open source software programs. Many of the risks associated with the usage of open source software cannot be eliminated, and could harm our business.

**Risks Related to Regulatory Matters**

Failure to comply with laws and regulations could harm our business and our reputation.

Our business is subject to regulation by various federal, state, local and foreign governmental agencies, including agencies responsible for monitoring and enforcing employment and labor laws, workplace safety, environmental laws, consumer protection laws, anti-bribery laws, import/export controls, federal securities laws and tax laws and regulations. In certain jurisdictions, these regulatory requirements may be more stringent than those in the United States and in other circumstances these requirements may be more stringent in the United States. Noncompliance with applicable regulations or requirements could subject us to investigations, sanctions, mandatory recalls, enforcement actions, disgorgement of profits, fines, damages, civil and criminal penalties or injunctions. If any governmental sanctions, fines or penalties are imposed, or if we do not prevail in any possible civil or criminal litigation, our business, operating results, financial condition and our reputation could be harmed. In addition, responding to any action will likely result in a significant diversion of management's attention and resources and an increase in professional fees. Enforcement actions and sanctions could further harm our business, operating results, financial condition and our reputation.

Increased taxes on our service may increase our clients' cost of using our service and/or increase our costs and reduce our profit margins to the extent the costs are not passed through to our clients, and we may be subject to liabilities for past sales and other taxes, surcharges and fees.

Prior to 2012, we did not collect or remit state or local sales, use, gross receipts, excise and utility user taxes, fees or surcharges on our solution.

During 2011, we analyzed our activities and determined that we were obligated to collect sales taxes on sales of our subscription services in certain states. Accordingly, we registered with those states and, in 2012, commenced paying past-due amounts and collecting sales taxes from our clients and remitting such taxes to the applicable state taxing authorities. During the first quarter of 2015, we conducted an updated review of the taxability of sales of our subscription services and identified four additional U.S. states where we may be obligated to collect and remit sales

taxes.

48

---

Table of Contents

During 2013, we analyzed our activities and determined that we may be obligated to collect and remit sales, excise and utility user taxes, as well as surcharges as a communications service provider, and pay gross receipts taxes, on our usage-based fees in certain states and municipalities. We neither collected nor remitted state and local taxes or surcharges on usage-based fees in any of the periods prior to 2014. Based on our ongoing assessment of our state and local tax collection and remittance obligations in respect of usage-based fees, in 2014, we registered for tax and regulatory purposes in all states where we determined such registration is proper and commenced collecting and remitting applicable state and local taxes and surcharges on such fees.

We have accrued a contingent liability for our best estimate of the probable amount of taxes and surcharges that may be imposed by various states and municipalities on our activities, including our usage-based and subscription services, prior to registration. This contingent liability is based on our analysis of a number of factors, including the source location of our usage-based fees, the taxability of our subscription services and the rules and regulations in each state. The actual amount of state and local taxes and surcharges paid may differ from our estimates. See Note 10 to the notes to our condensed consolidated financial statements.

While we have accrued for these potential liabilities in each period, such accruals are based on analyses of our business activities, the operation of our solution, applicable statutes, regulations and rules in each state and locality and estimates of sales subject to sales tax or other charges. State and local taxing and regulatory authorities may challenge our position and may decide to audit our business and operations with respect to state or local sales, use, gross receipts, excise and utility user taxes, fees or surcharges, which could result in our being liable for taxes, fees, or surcharges, as well as related penalties and interest, above our recorded accrued liability or additional liability for taxes, fees, or surcharges, as well as penalties and interest for our clients, which could harm our results of operations and our relationships with our clients.

The applicability of state or local taxes, fees or surcharges relative to services such as ours is complex, ambiguous and subject to interpretation and change. If states enact new legislation or if taxing and regulatory authorities promulgate new rules or regulations or expand or otherwise alter their interpretations of existing rules and regulations, we could incur additional liabilities. In addition, the collection of additional taxes, fees or surcharges in the future could increase our prices or reduce our profit margins. Compliance with new or existing legislation, rules or regulations may also make us less competitive with those competitors who are not subject to, or choose not to comply with, such legislation, rules or regulations. We have incurred, and will continue to incur, substantial ongoing costs associated with complying with state or local tax, fee or surcharge requirements in the numerous markets in which we conduct or will conduct business.

We are subject to assessments for unpaid Universal Service Fund contributions, as well as interest thereon and civil penalties, due to our late registration and past failure to recognize our obligation as a USF contributor and as an international carrier.

During the third quarter of 2012, we determined that based on our business activities, we are classified as a telecommunications service provider for regulatory purposes and we are required to make direct contributions to the USF based on revenue we receive from the resale of interstate and international telecommunications services. Previously, we had been advised that our telecommunications services were an integral part of an information service and accordingly made indirect USF contributions as an end user through payments to our wholesale telecommunications service providers. In order to comply with the obligation to make direct contributions, in November 2012, we made a voluntary self-disclosure to the FCC Enforcement Bureau and have registered with the USAC which is charged by the FCC with administering the USF. As of March 31, 2015, we had a promissory note issued to USAC in the principal amount of \$2.4 million and accrued liabilities for unpaid USF contributions of \$5.5 million, which are included in accrued federal fees in the consolidated balance sheet. Approximately \$0.8 million of these amounts pertains to periods prior to 2008. In April 2013, we began remitting required contributions on a prospective basis directly to USAC.

Our registration with USAC subjects us to assessments for unpaid USF contributions, as well as interest thereon and civil penalties, due to our late registration and past failure to recognize our obligation as a USF contributor and as an international carrier. We are required to pay assessments for periods prior to our registration. While we are in administrative proceedings before the FCC to limit such back assessments to the period 2008 through 2012, it is

possible that we will be required to pay back assessments for the period from 2003 to 2007. We have submitted two separate Requests for Review (a form of appeal) to the FCC's Wireline Bureau challenging the application of FCC rules to the assessments of USF fees for 2003 to 2007, and from 2008 to 2012. The FCC has not yet resolved either of those Requests for Review. If the pending disputes are not resolved in our favor, it is possible that we will be required to pay additional back assessments for one or both of those periods. The first Request for

Table of Contents

Review, which relates to 2003 to 2007 fees, asks the FCC to apply its discretion and relieve us from paying USF fees for those aging fees. The second Request for Review, which applies to both periods, seeks to obtain credit for the indirect USF payments we have made since 2003 to our wholesale telecommunications service providers. If we are unsuccessful in obtaining credit from the FCC for these payments, we will seek reimbursement from our wholesale telecommunication service providers. We will face a regulatory and contractual challenge in seeking recovery or credit for our USF reimbursement payments previously made to our wholesale telecommunication service providers. In 2012, we also determined that we were a provider of international telecommunications services and therefore we were required to secure from the FCC a section 214 international carrier authorization permitting such international telecommunications. We applied with the FCC for international carrier authority and also applied for, and received, special temporary authority ("STA") to continue to provide international telecommunications services while our international carrier application remains pending before the FCC. Our STA has since been renewed on three occasions and may be renewed again before the international authorization is granted.

Finally, in October 2014, the FCC Enforcement Bureau began to negotiate a consent decree and a voluntary civil penalty with us, the amount of which has been tentatively set at \$2.0 million, to conclude its investigation into our 2008 - 2012 USF contribution and international carrier authorization compliance. See Note 10 of the notes to our condensed consolidated financial statements.

Our ongoing obligations to pay federal, state and local telecommunications contributions and taxes may decrease our price advantage over our competitors who have historically paid these contributions and taxes and could also make us less competitive with those competitors who are not subject to, or choose not to comply with, those requirements. In addition, if we are unable to continue to pass some or all of the cost of these contributions and taxes to our clients, our profit margins on the minutes we resell will decrease. Our federal contributions and tax obligations may significantly increase in the future, due to new interpretations by governing authorities, governmental budget pressures, changes in our business model or solutions or other factors. See Note 10 of the notes to our condensed consolidated financial statements.

If we do not comply with FCC rules and regulations, we could be subject to further FCC enforcement actions, fines, loss of licenses and possibly restrictions on our ability to operate or offer certain of our services.

Since our business is regulated by the FCC, we are subject to existing or potential FCC regulations relating to privacy, disability access, porting of numbers, USF contributions and other requirements. If we do not comply with FCC rules and regulations, we could be subject to further FCC enforcement actions, fines, loss of licenses and possibly restrictions on our ability to operate or offer certain of our services. Any further enforcement action by the FCC, which may be a public process, would hurt our reputation in the industry, possibly impair our ability to sell our services to clients and could harm our business and results of operations.

Among the regulations to which we are subject, we must comply (in whole or in part) with:

- the Communications Assistance for Law Enforcement Act, or CALEA, which requires covered entities to assist law enforcement in undertaking electronic surveillance;

- contributions to the USF which requires that we pay a percentage of our revenues resulting from the provision of interstate telecommunications services to support certain federal programs;

- payment of annual FCC regulatory fees based on our interstate and international revenues;

- rules pertaining to access to our services by people with disabilities and contributions to the Telecommunications Relay Services fund; and

- FCC rules regarding Customer Proprietary Network Information, or CPNI, which prohibit us from using such information without client approval, subject to certain exceptions.

If we do not comply with any current or future rules or regulations that apply to our business, we could be subject to additional and substantial fines and penalties, we may have to restructure our service offerings, exit certain markets, accept lower margins or raise the price of our services, any of which could ultimately harm our business and results of operations.

Reform of federal and state USF programs could increase the cost of our service to our clients, diminishing or eliminating our pricing advantage.

The FCC and a number of states are considering reform or other modifications to USF programs. The way we calculate our contribution may change if the FCC or certain states engage in reform or adopt other modifications. In

50

---

Table of Contents

April 2012, the FCC released a Further Notice of Proposed Rulemaking to consider reforms to the manner in which companies like us contribute to the federal USF program. In general, the Further Notice of Proposed Rulemaking is considering questions like: what companies should contribute, how contributions should be assessed, and methods to improve the administration of the system. We cannot predict the outcome of this proceeding nor its impact on our business at this time.

Should the FCC or certain states adopt new contribution mechanisms or otherwise modify contribution obligations that increase our contribution burden, we will either need to raise the amount we currently collect from our clients to cover this obligation or absorb the costs, which would reduce our profit margins. Furthermore, the FCC has ruled that states can require us to contribute to state USF programs. A number of states already require us to contribute, while others are actively considering extending their programs to include the solution we provide. We currently pass through USF contributions to our clients which may result in our solution becoming less competitive as compared to those provided by our competitors.

Privacy concerns and domestic or foreign laws and regulations may reduce the demand for our solution, increase our costs and harm our business.

Our clients can use our solution to collect, use and store information, including personally identifiable information or other information treated as confidential, regarding their customers and potential customers. Federal, state and foreign government bodies and agencies have adopted, are considering adopting, or may adopt laws and regulations, including the Health Insurance Portability and Accountability Act of 1996, regarding the collection, use, storage and disclosure of such information obtained from consumers and individuals. The costs of compliance with, and other burdens imposed by, such laws and regulations that are applicable to the businesses of our clients may limit the use and adoption of our solution and reduce overall demand, or lead to significant fines, penalties or liabilities for any noncompliance with such privacy laws. Furthermore, privacy concerns may cause consumers to resist providing the personal data necessary to allow our clients to use our solution effectively. Even the perception of privacy concerns, whether or not valid, may inhibit market adoption of our solution in certain industries or countries.

Domestic and international legislative and regulatory initiatives may harm our clients' ability to process, handle, store, use and transmit information, including demographic and personally identifiable information or other information treated as confidential, regarding their customers, which could reduce demand for our solution. The European Union and many countries in Europe have particularly stringent privacy laws and regulations, which may impact our ability to profitably operate in certain European countries.

In addition to government activity, privacy advocacy groups and the technology and other industries are considering various new, additional or different self-regulatory standards that may place additional burdens on us. If the processing of information were to be curtailed in this manner, our solution may be less attractive, which may reduce demand for our solution and harm our business.

**Risks Related to Ownership of Our Common Stock**

Our stock price has been volatile, may continue to be volatile and may decline, including due to factors beyond our control.

The market price of our common stock has been volatile in the past and may fluctuate significantly in the future in response to numerous factors, many of which are beyond our control. During the three months ended March 31, 2015, the sale price per share of our common stock ranged from a low of \$3.64 to a high of \$5.71. Factors that may contribute to continuing volatility in the price of our common stock include:

- actual or anticipated fluctuations in our operating results;
- the financial projections we provide to the public, any changes in these projections or our failure to meet these projections;
- failure of securities analysts to initiate or maintain coverage of our company, changes in financial estimates by any securities analysts who follow our company, or our failure to meet these estimates or the expectations of investors;
- ratings changes by any securities analysts who follow our company;
- announcements by us or our competitors of significant technical innovations, acquisitions, strategic partnerships, joint ventures or capital commitments;





Table of Contents

changes in operating performance and stock market valuations of other technology companies generally, or those in the SaaS industry in particular;

price and volume fluctuations in the overall stock market, including as a result of trends in the U.S. or global economy;

any major change in our board of directors or management;

lawsuits threatened or filed against us;

legislation or regulation of our business, the internet and/or contact centers;

loss of key personnel;

new entrants into the contact center market, including the transition by providers of legacy on-premise contact center systems to cloud solutions, as well as cable and incumbent telephone companies and other well-capitalized competitors;

new products or new sales by us or our competitors;

the perceived or real impact of events that harm our direct competitors;

developments with respect to patents or proprietary rights;

general market conditions; and

other events or factors, including those resulting from war, incidents of terrorism or responses to these events, which could be unrelated to, or outside of, our control.

In addition, stock markets have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many technology companies. Stock prices of many technology companies have fluctuated in a manner unrelated or disproportionate to the operating performance of those companies. These and other factors may disproportionately impact the trading price of our common stock. In the past, stockholders have instituted securities class action litigation following periods of market volatility. If we were to become involved in securities litigation, it could subject us to substantial costs, divert resources and the attention of management from our business and harm our business, results of operations, financial condition, reputation and cash flows.

If securities or industry analysts discontinue publishing research or reports about our business, or publish negative reports about our business, our share price and trading volume could decline.

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

Substantial future sales of shares of our common stock could cause the market price of our common stock to decline. The market price of shares of our common stock could decline as a result of substantial sales of our common stock, particularly sales by our directors, executive officers and significant stockholders or the perception in the market that holders of a large number of shares intend to sell their shares.

As of April 30, 2015, the holders of an aggregate of 24,530,809 shares of our outstanding common stock have rights, subject to certain conditions, to require us to file registration statements covering their shares or to include their shares in registration statements that we may file for ourselves or our stockholders. The filing of a registration statement for these shares may cause our stock price to decline, even before such shares are actually sold in the market. We have also registered shares of common stock that we may issue under our employee equity incentive plans. These shares will be able to be sold freely in the public market upon issuance.

The requirements of being a public company may strain our resources, divert management's attention and harm our business and operating results.

As a public company, we are subject to the reporting requirements of the Securities Exchange Act of 1934, as amended, or the Exchange Act, the Sarbanes-Oxley Act, the Dodd-Frank Act, the listing requirements of NASDAQ and other applicable securities laws, rules and regulations. Compliance with these laws, rules and regulations will



Table of Contents

continue to increase our legal and financial compliance costs, make some activities more difficult, time-consuming or costly and increase demand on our systems and resources, particularly after we are no longer an “emerging growth company.” The Exchange Act requires, among other things, that we file annual, quarterly and current reports with respect to our business and operating results. The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal control over financial reporting. In order to maintain and, if required, improve our disclosure controls and procedures and internal control over financial reporting to meet this standard, significant resources and management oversight may be required. As a result, management’s attention may be diverted from other business concerns and our costs and expenses will increase, which could harm our business and operating results. Although we have already hired additional employees to comply with these requirements, we may need to hire more employees in the future or engage outside consultants, which will increase our costs and expenses. In addition, changing laws, regulations and standards relating to corporate governance and public disclosure are creating uncertainty for public companies, increasing legal and financial compliance costs and making some activities more time consuming. These laws, regulations and standards are subject to varying interpretations, in many cases due to their lack of specificity and, as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies. This could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We intend to invest resources to comply with evolving laws, regulations and standards, and this investment may result in increased general and administrative expenses and a diversion of management’s time and attention from revenue-generating activities to compliance activities. If our efforts to comply with new laws, regulations and standards differ from the activities intended by regulatory or governing bodies due to ambiguities related to their application and practice, regulatory authorities may initiate legal proceedings against us and our business may be harmed.

As a result of disclosure of information in our public filings, our business and financial condition are and will continue to be more visible, which could be advantageous to our competitors and clients and could result in threatened or actual litigation, including by competitors and other third parties. If such claims are successful, our business and operating results could be harmed, and even if the claims are resolved in our favor, these claims, and the time and resources necessary to resolve them, could divert the resources of our management and harm our business and operating results. We are an emerging growth company and we cannot be certain if the reduced disclosure requirements applicable to emerging growth companies will make our common stock less attractive to investors.

We are an “emerging growth company” as defined in the JOBS Act. Under the JOBS Act, emerging growth companies can delay adopting new or revised financial accounting standards until such time as those standards apply to private companies. We have irrevocably elected not to avail ourselves of this extended transition period and, therefore, we will be subject to the same new or revised accounting standards as other public companies that are not “emerging growth companies.”

For as long as we continue to be an emerging growth company, we may take advantage of certain other exemptions from reporting requirements that are applicable to other public companies including, but not limited to, not being required to comply with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements, and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and stockholder approval of any golden parachute payments not previously approved. Investors may find our common stock less attractive because we rely on these exemptions. If some investors find our common stock less attractive as a result, there may be a less active trading market for our common stock and our stock price may be more volatile or decline.

We will remain an emerging growth company until the earliest of (i) the end of the fiscal year in which the market value of our common stock that is held by non-affiliates is at least \$700 million as of the last business day of our most recently completed second fiscal quarter, (ii) the end of the fiscal year in which we have total annual gross revenues of \$1 billion or more during such fiscal year, (iii) the date on which we issue more than \$1 billion in non-convertible debt in a three-year period or (iv) the end of fiscal 2019.

Table of Contents

Anti-takeover provisions in our charter documents and under Delaware law could make an acquisition of our company more difficult, limit attempts by our stockholders to replace or remove our current management and limit the market price of our common stock.

Provisions in our amended and restated certificate of incorporation and amended and restated bylaws may have the effect of delaying or preventing a change in control or changes in our management. Our amended and restated certificate of incorporation and amended and restated bylaws:

provide that our board of directors is classified into three classes of directors;

provide that stockholders may remove directors only for cause and only with the approval of holders of at least  $66\frac{2}{3}\%$  of our then outstanding capital stock;

provide that the authorized number of directors may be changed only by resolution of the board of directors;

provide that all vacancies, including newly created directorships, may, except as otherwise required by law, be filled by the affirmative vote of a majority of directors then in office, even if less than a quorum;

provide that our stockholders may not take action by written consent, and may only take action at annual or special meetings of our stockholders;

provide that stockholders seeking to present proposals before a meeting of stockholders or to nominate candidates for election as directors at a meeting of stockholders must provide notice in writing in a timely manner, and also specify requirements as to the form and content of a stockholder's notice;

restrict the forum for certain litigation against us to Delaware;

do not provide for cumulative voting rights (therefore allowing the holders of a majority of the shares of common stock entitled to vote in any election of directors to elect all of the directors standing for election);

provide that special meetings of our stockholders may be called only by the chairman of the board, our chief executive officer or the board of directors pursuant to a resolution adopted by a majority of the total number of authorized directors; and

provide that stockholders will be permitted to amend our amended and restated bylaws only upon receiving at least  $66\frac{2}{3}\%$  of the votes entitled to be cast by holders of all outstanding shares then entitled to vote generally in the election of directors, voting together as a single class.

These provisions may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace members of our board of directors, which is responsible for appointing the members of our management. In addition, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which generally prohibits a Delaware corporation from engaging in any of a broad range of business combinations with any "interested" stockholder for a period of three years following the date on which the stockholder became an "interested" stockholder.

Our amended and restated certificate of incorporation provides that the Court of Chancery of the State of Delaware is the sole and exclusive forum for substantially all disputes between us and our stockholders, which could limit our stockholders' ability to obtain a favorable judicial forum for disputes with us or our directors, officers or employees.

Our amended and restated certificate of incorporation provides that, unless we consent to the selection of an alternative forum, the Court of Chancery of the State of Delaware is the sole and exclusive forum for (1) any derivative action or proceeding brought on our behalf, (2) any action asserting a claim of breach of fiduciary duty owed by any of our directors, officers or other employees to us or to our stockholders, (3) any action asserting a claim arising pursuant to the Delaware General Corporation Law or (4) any action asserting a claim governed by the internal affairs doctrine. The choice of forum provision may limit a stockholder's ability to bring a claim in a judicial forum that it finds favorable for disputes with us or our directors, officers or other employees, which may discourage such lawsuits against us and our directors, officers and other employees. Alternatively, if a court were to find the choice of forum provision contained in our amended and restated certificate of incorporation to be inapplicable or unenforceable in an action, we may incur additional costs associated with resolving such action in other jurisdictions, which could harm our business, operating results and financial condition.

Table of Contents

We have never paid cash dividends and do not intend to pay dividends for the foreseeable future.

We have never declared or paid any cash dividends on our common stock. We currently intend to retain any future earnings and do not expect to pay any dividends in the foreseeable future. Any future determination to declare cash dividends will be made at the discretion of our board of directors, subject to applicable laws, and will depend on a number of factors, including our financial condition, results of operations, capital requirements, contractual restrictions, general business conditions and other factors that our board of directors may deem relevant. In addition, our secured credit agreement prohibits us and our subsidiaries from, among other things, paying any dividends or making any other distribution or payment on account of our common stock. Accordingly, holders of our common stock must rely on sales of their common stock after price appreciation, which may never occur, as the only way to realize any future gains on their investments.

Our directors, executive officers and significant stockholders, who hold approximately 54% of the voting power of our outstanding common stock, have substantial control over us and could delay or prevent a change in corporate control.

As of April 30, 2015, our directors, executive officers and holders of more than 5% of our common stock, together with their affiliates, beneficially owned, in the aggregate, approximately 54% of our outstanding common stock. As a result, these stockholders, acting together, have the ability to control the outcome of matters submitted to our stockholders for approval, including the election of directors and any merger, consolidation or sale of all or substantially all of our assets. In addition, these stockholders, acting together, have the ability to control the management and affairs of our company. Accordingly, this concentration of ownership might decrease the market price of our common stock by:

- delaying, deferring or preventing a change in control of Five9;
- impeding a merger, consolidation, takeover or other business combination involving us; or
- discouraging a potential acquirer from making a tender offer or otherwise attempting to obtain control of Five9.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

Sales of Unregistered Securities

There were no sales of unregistered securities during the three months ended March 31, 2015.

ITEM 3. Defaults Upon Senior Securities

None.

ITEM 4. Mine Safety Disclosures

Not applicable.

ITEM 5. Other Information

None.

Table of Contents

ITEM 6. Exhibits

Exhibit Number	Description
3.1	Amended and Restated Certificate of Incorporation of Five9, Inc. (filed as Exhibit 3.2 to the Company's Current Report on Form 8-K filed with the SEC on April 10, 2014 (File No. 001-36383) and incorporated by reference herein).
3.2	Amended and Restated Bylaws of Five9, Inc. (filed as Exhibit 3.1 to the Company's Current Report on Form 8-K filed with the SEC on April 10, 2014 (File No. 001-36383) and incorporated by reference herein).
10.1	Second Amendment to Loan and Security Agreement, dated February 19, 2015, by and between Five9, Inc., Five9 Acquisition LLC, Fifth Street Finance Corp. and Fifth Street Mezzanine Partners V, L.P. (filed as Exhibit 10.1 to the Company's Current Report on Form 8-K filed with the SEC on February 25, 2015 (File No. 001-36383) and incorporated by reference herein).
10.2	2015 Executive Bonus Plan (filed as Exhibit 10.14 to the Company's Annual Report on Form 10-K filed with the SEC on March 10, 2015 (File No. 001-36383) and incorporated by reference herein).
10.3*	Offer Letter between the Registrant and Michael Crane.
31.1*	Certification of Chief Executive Officer of Five9, Inc. Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Chief Financial Officer of Five9, Inc. Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1**	Certification of Chief Executive Officer and Chief Financial Officer of Five9, Inc. Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Schema Linkbase Document
101.CAL*	XBRL Taxonomy Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Definition Linkbase Document
101.LAB*	XBRL Taxonomy Labels Linkbase Document
101.PRE*	XBRL Taxonomy Presentation Linkbase Document

\* Filed herewith.

\*\* Furnished herewith.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Five9, Inc.

Date: May 13, 2015

By: /s/ Michael Burkland  
Michael Burkland  
Chief Executive Officer and President  
(Duly Authorized Officer)

Date: May 13, 2015

By: /s/ Barry Zwarenstein  
Barry Zwarenstein  
Chief Financial Officer  
(Principal Financial Officer)