RingCentral Inc
Form 10-Q
November 08, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File Number: 001-36089

RingCentral, Inc.

(Exact Name of Registrant as Specified in its Charter)

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

20 Davis Drive

Belmont, California 94002

(Address of principal executive offices)

(650) 472-4100

(Registrant’s telephone number, including area code)

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

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

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

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

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

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

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

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

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

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

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

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

PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

RINGCENTRAL, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited, in thousands)

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

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

* See Note 2 for a summary of adjustments.

See accompanying notes to condensed consolidated financial statements

RINGCENTRAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited, in thousands, except per share data)

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

* See Note 2 for a summary of adjustments.

See accompanying notes to condensed consolidated financial statements

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RINGCENTRAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

(Unaudited, in thousands)

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

* See Note 2 for a summary of adjustments.

See accompanying notes to condensed consolidated financial statements

RINGCENTRAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in thousands)

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

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

* See Note 2 for a summary of adjustments.

See accompanying notes to condensed consolidated financial statements

RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

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

Description of Business

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

Basis of Presentation and Consolidation

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

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

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

Use of Estimates

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

Changes in Significant Accounting Policies

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

Revenue Recognition

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

The Company determines revenue recognition through the following steps:

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

RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

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

The Company recognizes revenues as follows:

Software subscriptions revenue

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

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

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

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

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

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

Other revenue

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

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

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

Deferred sales commission costs

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

RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

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

Disaggregation of revenue

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

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

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

Deferred revenue

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

Remaining performance obligations

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

Share-Based Compensation

Share-based compensation expense resulting from options, restricted stock units ("RSUs"), performance-based awards, and employee stock purchase plan ("ESPP") rights granted is measured as the grant date fair value of the award and is recognized using the straight-line attribution method over the requisite service period of the award, which is generally the vesting period. The Company estimates the fair value of stock options, ESPP rights, and performance-based awards using the Black-Scholes-Merton option-pricing model. The Company estimates the fair value of RSUs as the closing market value of its Class A Common Stock on the grant date. For awards with performance-based and service-based conditions, compensation cost is recognized over the requisite service period if it is probable that the performance condition will be satisfied. The expense for performance-based awards is evaluated each quarter based on the achievement of the performance conditions. The effect of a change in the estimated number of performance-based awards expected to be earned is recognized in the period those estimates are revised. Compensation expense for stock options and RSUs granted to non-employees is revalued, or marked to market, as of each reporting date until the stock options and RSUs are vested. Compensation expense is recognized net of estimated forfeiture activity, which is based on historical forfeiture rates.

Recent Accounting Pronouncements Not Yet Adopted

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

RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

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

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

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

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

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

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

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

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

RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 2. Impact of Recent Accounting Pronouncements

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

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

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

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

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

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

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RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

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

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

Note 3. Other Revenue and Cost of Revenue

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

Note 4. Financial Statement Components

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

| | September 30, 2018 | December 31, 2017 |
|---|---|---|

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

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

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

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

* See Note 2 for a summary of adjustments.

RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

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

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

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

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

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

Accrued liabilities consisted of the following (in thousands):

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

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

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

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

(1) Refer to Note 6 for details.

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

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Notes to Condensed Consolidated Financial Statements (Unaudited)

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

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

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

Deferred Sales Commission Costs

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

Note 5. Fair Value of Financial Instruments

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

Level 1: Observable inputs that reflect unadjusted quoted prices in active markets for identical assets or liabilities.
Level 2: Other inputs, such as quoted prices for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

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

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

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

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

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

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Notes to Condensed Consolidated Financial Statements (Unaudited)

As of September 30, 2018, the fair value of the 0% convertible senior notes due 2023 (the “Notes”) (described in Note 7 below) was approximately $577.1 million. The fair value was determined based on the quoted price for the Notes in an inactive market on the last trading day of the reporting period and is considered as Level 2 in the fair value hierarchy.

## Note 6. Acquired Customer Base

On January 16, 2018, the Company acquired from AT&T the existing customer base of the RingCentral Office@Hand solution, which was previously sold by AT&T, for a total purchase consideration of up to $26.0 million. The purchase price consisted of a $20.0 million cash payment upon closing of the transaction and up to $6.0 million in earn-out payments based on achievement of certain milestones. The transition of the customer base was expected to be completed over a period of one year from the close of the transaction. The Company had entered into a Transition Services Agreement (“TSA”) for a one-year period. The total purchase consideration was estimated to be approximately $24.0 million upon the close of the transaction, consisting of approximately $20.0 million cash payments, including transaction costs, and approximately $4.0 million earn-out consideration. The transaction was accounted for as an asset acquisition. The value of the total consideration was allocated between the customer relationship intangible asset of $22.0 million, to be amortized over the expected useful life of five years, and the TSA services of $2.0 million, to be amortized over the expected one year of service, based on their relative fair value. Under the terms of the agreement, a portion of the customers transitioned to the Company. The value of the customer base that transitioned to the Company is reflected as a customer relationship asset of approximately $10.0 million, to be amortized over the expected useful life of five years.

Subsequently on August 31, 2018, the Company and AT&T entered into a revised agreement through June 30, 2024, under which AT&T will resume reselling RingCentral solutions to its customers and obtain control over the non-transitioned customer base. The agreement also includes potential future payments, estimated to be approximately $2.0 million. In addition, under the agreement, AT&T retained the $20.0 million previously paid to them. Of these amounts, the value attributed to the non-transitioned customer base was approximately $12.0 million, which is treated as prepaid services for ongoing customer support for existing and new customers and will be amortized over the expected term of the agreement.

## Note 7. Convertible Senior Notes

In March 2018, the Company issued $400.0 million aggregate principal amount of 0% convertible senior notes due 2023 in a private placement and an additional $60.0 million aggregate principal amount of such notes pursuant to the exercise in full of the over-allotment options of the initial purchasers. The Notes do not bear regular interest, and the principal amount of the Notes does not accrete. The Notes may bear special interest under specified circumstances relating to the Company's failure to comply with its reporting obligations under the indenture relating to the issuance of Notes (the "Indenture") or if the Notes are not freely tradeable as required by the indenture. The Notes will mature on March 15, 2023, unless earlier repurchased or redeemed by the Company or converted pursuant to their terms. The total net proceeds from the debt offering, after deducting initial purchase discounts and debt issuance costs, were approximately $449.5 million.

Each $1,000 principal amount of the Notes is initially convertible into 12.2782 shares of the Company's Class A common stock par value $0.0001 ("Class A Common Stock"), which is equivalent to an initial conversion price of approximately $81.45 per share. The conversion rate is subject to adjustment upon the occurrence of certain specified events but will not be adjusted for any accrued and unpaid special interest. In addition, upon the occurrence of a make-whole fundamental change or a redemption period, each as defined in the Indenture, the Company will, in certain circumstances, increase the conversion rate by a number of additional shares for a holder that elects to convert its Notes in connection with such make-whole fundamental change or during the relevant redemption period.

Prior to the close of business on the business day immediately preceding December 15, 2022, the Notes will be convertible only under the following circumstances:

(1) during any calendar quarter commencing after June 30, 2018, and only during such calendar quarter, if the last reported sale price of the Class A Common Stock for at least 20 trading days (whether or not consecutive) in a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is more than 130% of the conversion price on each applicable trading day;

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(2) during the five business days period after any five consecutive trading days period in which, for each trading day of that period, the trading price per $1,000 principal amount of Notes for such trading day was less than 98% of the product of the last reported sale price of the Class A Common Stock and the conversion rate on each such trading day;

(3) upon the Company's notice that it is redeeming any or all of the Notes, at any time prior to the close of business on the scheduled trading day immediately preceding the redemption date; or

(4) upon the occurrence of specified corporate events.

On or after December 15, 2022, until the close of business on the scheduled trading day immediately preceding the maturity date, holders of the Notes may convert all or a portion of their Notes regardless of the foregoing conditions.

Upon conversion, the Company will pay or deliver, as the case may be, cash, shares of Class A Common Stock, or a combination of cash and shares of Class A Common Stock, at the Company's election. It is the Company's current intent to settle the principal amount of the Notes with cash.

During the three and nine months ended September 30, 2018, the conditions allowing holders of the Notes to convert were not met.

The Company may redeem the Notes, at its option, on or after September 20, 2020, at a redemption price equal to 100% of the principal amount thereof, plus accrued and unpaid special interest to, but excluding the redemption date, if the last reported sale price of the Class A Common Stock has been at least 130% of the conversion price then in effect for at least 20 trading days (whether or not consecutive) during any 30 consecutive trading day period ending within not more than three trading days preceding the date on which the Company provides written notice of redemption. No sinking fund is provided for the Notes. Upon the occurrence of a fundamental change (as defined in the Indenture) prior to the maturity date, holders may require the Company to repurchase all or a portion of the Notes for cash at a price equal to 100% of the principal amount of the Notes to be repurchased, plus any accrued and unpaid special interest to, but excluding, the fundamental change repurchase date.

The Notes are senior unsecured obligations and will rank senior in right of payment to any of the Company's indebtedness that is expressly subordinated in right of payment to the Notes; equal in right of payment with the Company's existing and future liabilities that are not so subordinated; effectively junior in right of payment to any of the Company's secured indebtedness to the extent of the value of the assets securing such indebtedness; and structurally junior to all indebtedness and other liabilities (including trade payables) of current or future subsidiaries of the Company.

In accounting for the issuance of the Notes, the Company separated the Notes into liability and equity components. The carrying amount of the liability component was calculated by measuring the fair value of a similar debt instrument that does not have an associated convertible feature. The carrying amount of the equity component representing the conversion option was $101.1 million and was determined by deducting the fair value of the liability component from the par value of the Notes. The equity component is not remeasured as long as it continues to meet the conditions for equity classification. The excess of the principal amount of the liability component over its carrying amount ("debt discount") is amortized to interest expense at an effective interest rate over the contractual terms of the Notes.

In accounting for the transaction costs related to the Notes, the Company allocated the total amount incurred to the liability and equity components of the Notes based on the proportion of the proceeds allocated to the debt and equity components. Issuance costs attributable to the liability component were $8.2 million were recorded as additional debt discount to be amortized to interest expense using the effective interest method over the contractual terms of the Notes. Issuance costs attributable to the equity component were netted with the equity component in stockholders' equity.

The net carrying amount of the liability component of the Notes was as follows (in thousands):

| | September 30, 2018 |
|---|---|
| Principal | $ 460,000 |
| Unamortized discount | (90,856 ) |
| Unamortized issuance cost | (7,507 ) |
| Net carrying amount | $ 361,637 |

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The net carrying amount of the equity component of the Notes was as follows (in thousands):

| | |
|---|---|
| Proceeds allocated to the conversion option (debt discount) | $101,141 |
| Issuance cost | (2,318) |
| Net carrying amount | $98,823 |

The following table sets forth the interest expense recognized related to the Notes (in thousands):

| | For the Three Months Ended September 30, | | For the Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Contractual interest expense | $ — | $ — | $ — | $ — |
| Amortization of debt discount | 4,530 | — | 10,286 | — |
| Amortization of debt issuance costs | 319 | — | 717 | — |
| Total interest expense related to the Notes | $ 4,849 | $ — | $ 11,003 | $ — |

In connection with the offering of the Notes, the Company entered into privately-negotiated capped call transactions with certain counterparties (the "Capped Calls"). The Capped Calls each have an initial strike price of approximately $81.45 per share, subject to certain adjustments, which corresponds to the initial conversion price of the Notes. The Capped Calls have initial cap prices of $119.035 per share, subject to certain adjustments. The Capped Calls cover, subject to anti-dilution adjustments, approximately 5.6 million shares of Class A Common Stock. The Capped Calls are generally intended to reduce or offset the potential dilution to the Class A Common Stock upon any conversion of the Notes with such reduction or offset, as the case may be, subject to a cap based on the cap price. The Capped Calls settle in components commencing January 13, 2023 with the last component expiring on March 13, 2023. The Capped Calls are subject to either adjustment or termination upon the occurrence of specified extraordinary events affecting the Company, including a merger event; a tender offer; and a nationalization, insolvency or delisting involving the Company. In addition, the Capped Calls are subject to certain specified additional disruption events that may give rise to a termination of the Capped Calls, including changes in law; insolvency filings; and hedging disruptions. The Capped Call transactions are recorded in stockholders' equity and are not accounted for as derivatives. The net cost of $49.9 million incurred to purchase the Capped Call transactions was recorded as a reduction to additional paid-in capital on the consolidated balance sheet.

Concurrently with the issuance of the Notes, the Company's board of directors approved the repurchase of an aggregate of 239,425, or $15.0 million of, shares of the Company's outstanding Class A Common Stock in privately negotiated transactions at a price of $62.65 per share, which was equal to the closing price per share of the Company's Class A Common Stock on March 1, 2018, the date of the pricing of the offering of the Notes. The share repurchase was recorded as a reduction of additional paid-in capital on the consolidated balance sheet.

Note 8. Commitments and Contingencies

Leases

The Company leases facilities for office space under non-cancelable operating leases for its U.S. and international locations and has entered into capital lease arrangements to obtain property and equipment for its operations. In addition, the Company leases space from third-party datacenter hosting facilities under co-location agreements to support its cloud infrastructure. The Company leases space for its corporate headquarters in Belmont, California through July 2021.

Sales Tax Liability

The Company regularly increases its sales and marketing activities in various states within the U.S., which may create nexus in those states to collect sales taxes on sales to customers. Although the Company is diligent in collecting and remitting such taxes, there is uncertainty as to what constitutes sufficient in-state presence for a state to levy taxes, fees, and surcharges for sales made over the Internet. As of September 30, 2018 and December 31, 2017, the Company recorded a long-term sales tax liability of $1.5 million and $2.6 million, respectively, which is included in other long-term liabilities, based on its best estimate of the probable liability for the loss contingency incurred as of those dates. The Company's estimate of a probable outcome under the loss contingency is based on analysis of its sales and marketing activities, revenues subject to sales tax, and applicable regulations in each state in each period. No

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significant adjustments to the long-term sales tax liability have been recognized in the accompanying condensed consolidated financial statements for changes to the assumptions underlying the estimate. However, changes in management's assumptions may occur in the future as the Company obtains new information which can result in adjustments to the recorded liability. Increases and decreases to the long-term sales tax liability are recorded as general and administrative expense.

The Company recorded a current sales tax liability for non-contingent amounts expected to be remitted in the next twelve months of $12.2 million and $9.0 million as of September 30, 2018 and December 31, 2017, respectively, which is included in accrued liabilities in the condensed consolidated balance sheet.

Legal Matters

From time to time, the Company 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 relating to various claims that arise in the normal course of business.

The Company determines whether an estimated loss from a contingency should be accrued by assessing whether a loss is deemed probable and can be reasonably estimated. The Company assesses its potential liability by analyzing specific litigation and regulatory matters using reasonably available information. The Company develops its views on estimated losses in consultation with inside and outside counsel, which involves a subjective analysis of potential results and outcomes, assuming various combinations of appropriate litigation and settlement strategies. Actual claims could settle or be adjudicated against the Company in the future for materially different amounts than the Company has accrued due to the inherently unpredictable nature of litigation. Legal fees are expensed in the period in which they are incurred.

TCPA Matters

On April 21, 2016, Supply Pro Sorbents, LLC ("SPS") filed a putative class action against the Company in the United States District Court for the Northern District of California, alleging common law conversion and violations of the federal Telephone Consumer Protection Act ("TCPA") arising from fax cover sheets used by the Company's customers when sending facsimile transmissions over the Company's system ("SPS Lawsuit"). SPS seeks statutory damages, costs, attorneys' fees and an injunction in connection with its TCPA claim, and unspecified damages and punitive damages in connection with its conversion claim. On July 6, 2016, the Company filed a Petition for Expedited Declaratory Ruling before the Federal Communications Commission ("FCC"), requesting that the FCC issue a ruling clarifying certain portions of its regulations promulgated under TCPA at issue in the SPS Lawsuit ("Petition"). The Petition remains pending. On July 8, 2016, the Company filed a motion to dismiss the SPS Lawsuit in its entirety, along with a collateral motion to dismiss or stay the SPS Lawsuit pending a ruling by the FCC on the Company's Petition. On October 7, 2016, the Court granted the Company's motion to dismiss and gave SPS 20 days to amend its complaint. The Court concurrently dismissed the Company's motion to dismiss or stay as moot. Plaintiff filed its amended complaint on October 27, 2016, alleging essentially the same theories and claims. On November 21, 2016, the Company filed a motion to dismiss the amended complaint, along with a renewed motion to dismiss or stay the case pending resolution of the FCC Petition. On July 17, 2017, the Court granted the Company's motion to dismiss with prejudice and concurrently dismissed the Company's motion to dismiss or stay as moot. SPS filed a notice of appeal to the Ninth Circuit Court of Appeals on July 28, 2017. SPS's opening brief on appeal was filed on December 20, 2017; asking that the dismissal be reversed and the case be returned to the district court for the Lawsuit to be processed. The Company's answering brief was filed on February 20, 2018; asking that the dismissal be affirmed. SPS filed its reply brief on April 12, 2018. Oral argument had been scheduled to be heard on November 16, 2018, but on October 23, 2018, the district court ordered that the case be submitted on the briefs and record without oral argument. There is no deadline for the Ninth Circuit Court of Appeals to then issue its decision. It is too early to predict the outcome of the SPS Lawsuit. Based on the information known by the Company as of the date of this filing and the rules and regulations applicable to the preparation of the Company's condensed consolidated financial statements, it is not possible to provide an estimated amount of any such loss or range of loss that may occur.

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On November 17, 2017, Joann Hurley ("Hurley"), filed a second amended complaint in an ongoing putative class action lawsuit pending in the United States District Court for the Southern District of West Virginia, adding the Company as a named defendant and alleging that the Company and other defendants violated the TCPA and regulations promulgated thereunder by allegedly using an automated telephone dialing system to deliver prerecorded political messages to Hurley, an incumbent running for reelection, and others. Hurley alternatively alleges that the Company is vicariously liable for the actions of its co-defendants. Hurley seeks statutory, compensatory, consequential, incidental and punitive damages, costs, and attorneys' fees in connection with her claims. The Company was served with the second amended complaint on January 4, 2018. On March 23, 2018, the Company filed a motion to dismiss the complaint for lack of standing and failure to sufficiently state a claim on which relief may be granted. Hurley filed her opposition brief on April 6, 2018, and the Company filed its reply brief on April 13, 2018. On October 4, 2018, the district court issued its memorandum and opinion order granting in part and denying in part the Company's motion to dismiss. The district court dismissed Hurley's vicarious liability claim but allowed Hurley's TCPA claim to proceed. The Company filed its answer and affirmatives defenses to the second amended complaint on October 18, 2018. It is too early to predict the outcome of this lawsuit. Based on the information known by the Company as of the date of this filing and the rules and regulations applicable to the preparation of the Company's condensed consolidated financial statements, it is not possible to provide an estimated amount of any such loss or range of loss that may occur.

Patent Infringement Matter

On April 25, 2017, Uniloc USA, Inc. and Uniloc Luxembourg, S.A. (together, "Uniloc") filed in the U.S. District Court for the Eastern District of Texas two actions against the Company alleging infringement of U.S. Patent Nos. 7,804,948; 7,853,000; and 8,571,194 by RingCentral's Glip unified communications application. The plaintiffs seek a declaration that the Company has infringed the patents, damages according to proof, injunctive relief, as well as their costs, attorney's fees, expenses and interest. On October 9, 2017, the Company filed a motion to dismiss or transfer requesting that the case be transferred to the United States District Court for the Northern District of California. In response to the motion, plaintiffs filed a first amended complaint on October 24, 2017. The Company filed a renewed motion to dismiss or transfer on November 15, 2017. Although briefing on that motion has been completed, the motion has not yet been decided. On February 5, 2018, Uniloc moved to stay the litigation pending the resolution of certain third-party inter partes review proceedings ("IPRs") before the United States Patent and Trademark Office. On February 9, 2018, the court stayed the litigation pending resolution of the IPRs without prejudice to or waiver of the Company's motion to dismiss or transfer. This litigation is still in its earliest stages. Based on the information known by the Company as of the date of this filing and the rules and regulations applicable to the preparation of the Company's condensed consolidated financial statements, it is not possible to provide an estimated amount of any such loss or range of loss that may occur. The Company intends to vigorously defend against this lawsuit.

Employment Matter

On August 13, 2018, the Company was sued by a former employee, Darren Stemple, in the United States District Court for the Northern District of California in a putative class and collective action alleging certain violations of federal and Colorado laws concerning overtime pay. The Stemple lawsuit is in its earliest stages, and it is too early to predict the outcome of this litigation. Based on the information known by the Company as of the date of this filing and the rules and regulations applicable to the preparation of the Company's condensed consolidated financial statements, the Company intends to contest the allegations but has accrued for an estimated loss that may occur.

Note 9. Share-Based Compensation

A summary of share-based compensation expense recognized in the Company’s condensed consolidated statements of operations is as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Cost of revenues | $1,315 | $1,026 | $3,626 | $2,821 |
| Research and development | 4,069 | 2,598 | 11,069 | 6,799 |
| Sales and marketing | 7,449 | 4,105 | 19,679 | 11,556 |
| General and administrative | 5,682 | 3,213 | 15,005 | 9,328 |
| Total share-based compensation expense | $18,515 | $10,942 | $49,379 | $30,504 |

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A summary of share-based compensation expense by award type is as follows (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Options | $762 | $1,489 | $2,726 | $5,632 |
| Employee stock purchase plan rights | 771 | 494 | 2,253 | 1,473 |
| Restricted stock units | 16,982 | 8,959 | 44,400 | 23,399 |
| Total share-based compensation expense | $18,515 | $10,942 | $49,379 | $30,504 |

Equity Incentive Plans

As of September 30, 2018, a total of 13,157,108 shares remained available for grant under the 2013 Equity Incentive Plan ("2013 Plan"). A summary of option activity under all of the Company's equity incentive plans at September 30, 2018 and changes during the period then ended is presented in the following table:

| | Number of Options Outstanding (in thousands) | Weighted-Average Exercise Price Per Share | Weighted-Average Contractual Term (in Years) | Aggregate Intrinsic Value (in thousands) |
|---|---|---|---|---|
| Outstanding at December 31, 2017 | 5,286 | $ 10.30 | 4.2 | $ 201,480 |
| Granted | — | — | | |
| Exercised | (911) | 8.47 | | |
| Canceled/Forfeited | (8) | 23.72 | | |
| Outstanding at September 30, 2018 | 4,367 | $ 10.66 | 3.5 | $ 360,016 |
| Vested and expected to vest as of September 30, 2018 | 4,347 | $ 10.63 | 3.5 | $ 358,289 |
| Exercisable as of September 30, 2018 | 4,076 | $ 10.23 | 3.5 | $ 337,555 |

No options were granted for the three and nine months ended September 30, 2018. The weighted average grant date fair value of options granted and the total intrinsic value of options exercised were as follows (in thousands, except weighted average grant date fair value):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Weighted average grant date fair value per share | $— | $— | $— | $9.08 |
| Total intrinsic value of options exercised | $18,842 | $9,489 | $58,063 | $32,752 |

The Company estimated the fair values of each option awarded on the date of grant using the Black-Scholes-Merton option pricing model, which requires inputs including the fair value of common stock, expected term, expected volatility, risk-free interest rate, and dividend yield.

The weighted-average assumptions used in the option pricing model in the periods presented were as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Expected term for employees (in years) | — | — | — | 4.4 |
| Expected term for non-employees (in years) | 3.0 | 4.8 | 3.2 | 5.0 |
| Risk-free interest rate | 2.9 % | 1.9 % | 2.6 % | 1.8 % |
| Expected volatility | 41.1 % | 42.4 % | 41.5 % | 43.7 % |
| Expected dividend yield | 0 % | 0 % | 0 % | 0 % |

RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

As of September 30, 2018, there was approximately $1.7 million of unrecognized share-based compensation expense, net of estimated forfeitures, related to non-vested stock option grants, which will be recognized on a straight-line basis over the remaining weighted-average vesting period of approximately 0.9 years.

Employee Stock Purchase Plan

The Employee Stock Purchase Plan (“ESPP”) allows eligible employees to purchase shares of the Company’s Class A common stock at a discounted price, through payroll deductions of up to the lesser of 15% of their eligible compensation or the IRS allowable limit per calendar year. A participant may purchase a maximum of 3,000 shares during an offering period. The offering periods are for a period of six months and generally start on the first trading day on or after May 13th and November 13th of each year. At the end of the offering period, the purchase price is set at the lower of: (i) 90% of the fair value of the Company’s Class A common stock at the beginning of the six month offering period and (ii) 90% of the fair value of the Company’s Class A common stock at the end of the six month offering period.

As of September 30, 2018, there was a total of $0.4 million of unrecognized share-based compensation expense, net of estimated forfeitures, related to ESPP, which will be recognized on a straight-line basis over the remaining weighted-average vesting period of approximately 0.1 years. At September 30, 2018, a total of 3,370,444 shares were available for issuance under the ESPP.

Restricted Stock Units

The 2013 Plan provides for the issuance of restricted stock units (“RSUs”) to employees, directors, and consultants. RSUs issued under the 2013 Plan generally vest over four years. A summary of activity of RSUs under the 2013 Plan at September 30, 2018, and changes during the period then ended is presented in the following table:

| | Number of RSUs Outstanding (in thousands) | Weighted-Average Grant Date Fair Value Per Share | Aggregate Intrinsic Value (in thousands) |
|---|---|---|---|
| Outstanding at December 31, 2017 | 4,281 | $ 25.51 | $ 207,197 |
| Granted | 1,529 | 66.06 | |
| Released | (1,492) | 29.57 | |
| Canceled/Forfeited | (382) | 35.02 | |
| Outstanding at September 30, 2018 | 3,936 | $ 38.79 | $ 366,216 |

As of September 30, 2018, there was a total of $112.5 million of unrecognized share-based compensation expense, net of estimated forfeitures, related to restricted stock units, which will be recognized on a straight-line basis over the remaining weighted-average vesting period of approximately 2.5 years.

Bonus Plan

In December 2017, the Board adopted the Selective 2018 Key Employee Equity Bonus Plan ("KEEB Plan"), which became effective on January 1, 2018. The KEEB Plan allows the recipients to earn fully vested shares of the Company's common stock upon the achievement of quarterly service and performance conditions. During the quarter ended September 30, 2018, 38,147 RSUs were issued under the KEEB Plan. The Company recognized an estimated $2.6 million and $6.5 million of expense on a straight-line basis during the three and nine months ended September 30, 2018, respectively, based on a total requisite service period of approximately 0.4 years.

The unrecognized share-based compensation expense was approximately $0.9 million, which will be recognized over the remaining service period of 0.1 year. The shares issued under this plan will be issued from the Company's 2013 Plan shares available for issuance.

RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

## Note 10. Segment Reporting

The Company has determined the chief executive officer is the chief operating decision maker. The Company's chief executive officer reviews financial information presented on a consolidated basis for purposes of assessing performance and making decisions on how to allocate resources. Accordingly, the Company has determined that it operates in a single reportable segment.

### Concentrations

Revenue by geographic location is based on the billing address of the customer. More than 90% of the Company's revenues were derived from the U.S. for each of the three and nine months ended September 30, 2018

Generally over 65% of the Company's total billings are collected through credit card payments. The Company's accounts receivable balance of $74.2 million as of September 30, 2018 primarily consists of receivables due from larger customers and carriers who are billed on invoices at customary payment terms. As the Company moves up-market and acquires larger customers, the Company expects the accounts receivable balance to increase. At September 30, 2018 and December 31, 2017, one of the Company's carriers accounted for 8% and 17% of the Company's total accounts receivable, respectively.

Long-lived assets by geographic location is based on the location of the legal entity that owns the asset. At September 30, 2018 and December 31, 2017, more than 90% and 85% of the Company's consolidated long-lived assets, respectively, were located in the U.S. with no single country outside of the U. S. representing more than 10% of the Company's consolidated long-lived assets.

## Note 11. Income Taxes

The provision for income taxes for the three months ended September 30, 2018 and 2017, was $108,000 and $73,000, respectively, and was $274,000 and $181,000 for the nine months ended September 30, 2018 and 2017, respectively, consisted primarily of state minimum taxes and foreign income taxes. For the three and nine months ended September 30, 2018 and 2017, the provision for income taxes differed from the U.S federal statutory rate primarily due to state and foreign taxes currently payable. Additionally, the Company realized no benefit for current year losses due to a full valuation allowance against the U.S. and the foreign net deferred tax assets.

The realization of tax benefits of net 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 entire domestic and the majority of the foreign net deferred tax assets as of September 30, 2018 and December 31, 2017. The Company intends to maintain the full valuation allowance on the U.S. net deferred tax assets until sufficient positive evidence exists to support a reversal of, or decrease in, the valuation allowance.

During the three and nine months ended September 30, 2018, there have been no significant changes to the total amount of unrecognized tax benefits.

Note 12. Basic and Diluted Net (Loss) Income Per Share

Basic net (loss) income per share is computed by dividing the net (loss) income by the weighted-average number of shares of common stock outstanding during the period, excluding the weighted-average unvested common stock subject to repurchase or forfeiture as they are not deemed to be issued for accounting purposes. Diluted net (loss) income per share is computed by giving effect to all potential shares of common stock, stock options, restricted stock units, and ESPP, to the extent dilutive. For the three and nine months ended September 30, 2018 and the nine months ended September 30, 2017, all such common stock equivalents have been excluded from diluted net loss per share as the effect to net loss per share would be anti-dilutive.

RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 *As Adjusted | 2018 | 2017 *As Adjusted |
| Numerator | | | | |
| Net (loss) income | $(9,518) | $269 | $(20,525) | $(4,083) |
| Denominator: | | | | |
| Weighted-average common shares outstanding for basic net (loss) income per share | 79,903 | 76,915 | 79,116 | 75,815 |
| Effect of dilutive securities: | | | | |
| Employee stock awards | — | 6,194 | — | — |
| Weighted-average common shares outstanding for diluted net (loss) income per share | 79,903 | 83,109 | 79,116 | 75,815 |
| Basic net (loss) income per share | $(0.12) | $0.00 | $(0.26) | $(0.05) |
| Diluted net (loss) income per share | $(0.12) | $0.00 | $(0.26) | $(0.05) |

* See Note 2 for a summary of adjustments.

The following table summarizes the potentially dilutive common shares that were excluded from diluted weighted-average common shares outstanding because including them would have had an anti-dilutive effect (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2018 | 2017 | 2018 | 2017 |
| Shares of common stock issuable under equity incentive awards outstanding | 8,789 | 4,236 | 9,198 | 11,108 |
| Convertible senior notes | 317 | — | 106 | — |
| Potential common shares excluded from diluted net loss per share | 9,106 | 4,236 | 9,304 | 11,108 |

Since the Company expects to settle the principal amount of its outstanding convertible senior notes in cash and any excess in shares of the Company's common stock, the Company uses the treasury stock method for calculating any potential dilutive effect of the conversion spread on diluted net income per share, if applicable. The conversion spread will have a dilutive impact on diluted net income per share of common stock when the average market price of the Company's common stock for a given period exceeds the conversion price of $81.45 per share for the Notes.

Note 13. Related Party Transactions

In the ordinary course of business, the Company made purchases from Google Inc., at which one of the Company's directors serves as President, Americas. Total payables to Google Inc. at September 30, 2018 and December 31, 2017 were $1.8 million and $1.1 million, respectively. Total expenses incurred from Google Inc. were $4.9 million and $14.4 million in the three and nine months ended September 30, 2018, respectively, and $3.9 million and $11.0 million for the three and nine months ended September 30, 2017, respectively.

RINGCENTRAL, INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 14. Subsequent Events

On October 22, 2018, the Company acquired all the shares of capital stock of Dimelo SA (“Dimelo”), a cloud-based digital customer engagement platform provider, for total consideration, net of cash acquired, of approximately $37 million, including up to $10 million in contingent consideration. In addition, the Company will issue approximately $3 million of restricted stock units which will vest over a period of up to four years. This will be recognized as compensation expense over the vesting period. The acquisition will enable the Company’s customers to manage all their digital customer interactions through a single platform. The acquisition will be accounted for as a business combination. Management is currently in the process of evaluating the impact of the business combination on its consolidated financial statements. The purchase price will be allocated to the tangible and intangible assets acquired and liabilities assumed based on their fair values at the acquisition date. The Company is currently performing procedures necessary to determine the purchase price allocation and will record the initial fair value estimates in the financial statements for the year ending December 31, 2018.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K filed with the SEC on February 26, 2018 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). As discussed in the section entitled "Special Note Regarding Forward-Looking Statements," the following discussion and analysis contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ significantly from those expressed or implied by such forward-looking statements. Factors that could cause or contribute to these differences include, but are not limited to, those discussed below and elsewhere in this report, particularly in the section entitled "Risk Factors" included under Part II, Item 1A below.

### Overview

We are a leading provider of software-as-a-service ("SaaS") solutions that enables businesses to communicate, collaborate, and connect. We believe that our innovative, cloud-based approach disrupts the large market for business communications and collaboration by providing flexible and cost-effective solutions that support distributed workforces, mobile employees, and the proliferation of smart phones and tablets. We enable convenient and effective communications for organizations across all their locations and employees, enabling them to be more productive and more responsive to their customers.

Our cloud-based business communications and collaboration solutions are designed to be easy to use, providing a single user identity across multiple locations and devices, including smartphones, tablets, PCs and desk phones. Our solutions can be deployed rapidly, configured and managed easily. Through our platform, we enable third-party developers and customers to integrate our solution with leading business applications or customize our solution to suit their own business workflows.

RingCentral has a portfolio of cloud-based offerings that are subscription based, made available at different monthly rates, varying by the specific functionalities, services, and number of users. We primarily generate revenues from the sale of software subscriptions to our offerings, which include the following:

RingCentral Office. Our flagship solution, RingCentral Office, provides a unified experience for communication and collaboration across multiple modes, including high-definition ("HD") voice, video, SMS, messaging and collaboration, conferencing, online meetings, and fax. Offered globally, customers can extend RingCentral Office to support their multinational workforce in many countries around the world.

RingCentral Contact Center. RingCentral Contact Center is a collaborative contact center solution that is omni-channel and integrates with RingCentral Office and RingCentral Glip and is offered at a monthly subscription based on three editions with varying features and capabilities. It enables businesses to transform the way they engage their customers across all channels while effectively maximizing agent availability.

RingCentral Glip. RingCentral Glip is a team messaging and collaboration solution that is made available as a feature to all RingCentral Office customers, and as a freemium offering to non-RingCentral users. It combines cloud communications with collaboration to make it easier to get teamwork done.

RingCentral Meetings. RingCentral Meetings is a collaborative meetings solution that offers web meetings, video conferencing, and screen sharing integrated with team messaging. Available stand-alone, this solution can be upgraded to the full cloud communications capabilities of RingCentral Office.

RingCentral Rooms. RingCentral Rooms extends the capabilities of RingCentral Meetings by delivering a cloud video conferencing solution that works for any sized conference room, using off-the-shelf equipment.

RingCentral Webinar. RingCentral Webinar is for large-scale virtual meetings. It can host multiple attendees and presenters and makes it easy to deliver web-based events or training to any desktop, tablet or smartphone.

RingCentral Live Reports. RingCentral Live Reports is an add-on for RingCentral Office customers to gather real-time information needed to maximize the performance with dashboards that contain information on agent utilization and overall customer experience.

RingCentral Professional. RingCentral Professional is a cloud based virtual telephone service offering designed for professionals who are on the go. It provides inbound call answering and management services, and includes inbound local, long-distance, and toll-free minutes.

RingCentral Fax. RingCentral Fax provides online fax capabilities that allow businesses to send and receive fax documents without the need for a fax machine. RingCentral Fax is made available to all RingCentral Office customers or as a stand-alone offering at monthly subscription rates that vary based on the desired number of pages and phone numbers allotted to the plan.

Our subscription plans have historically had monthly or annual contractual terms, although we also have subscription plans with multi-year contractual terms, generally with larger customers. We believe that this flexibility in contract duration is important to meet the different needs of our customers. Generally, most of our fees for subscription plans have been billed in advance via credit card or through commercial invoices with customary payment terms. We expect to bill more customers through commercial invoices, thus our level of accounts receivable may increase. As we increase our number of large customers, our level of prepayments from customers with annual or multi-year contracts may increase and, accordingly, our level of deferred revenue may increase. For each of the three and nine months ended September 30, 2018 and 2017, software subscriptions revenues accounted for more than 90% of our total revenues. The remainder of our revenues has historically been primarily comprised of product revenues from the sale of pre-configured office phones and professional services. We do not develop, manufacture, or otherwise touch the delivery of physical phones and offer it as a convenience for a total solution to our customers in connection with subscriptions to our services. We rely on third-party providers to develop and manufacture these devices and fulfillment partners to successfully serve our customers.

We make significant upfront investments to acquire customers. We continue to invest in our direct inside sales force while also developing indirect sales channels to market our brand and our subscription offerings. Our indirect sales channel consists of a network of resellers who sell our solutions, including regional and global master agents such as Intelysis Communications, Inc. (acquired by ScanSource, Inc.), Ingram Micro Inc. (acquired by HNA Group), Sandler Partners and AVANT, Inc.; and national partners such as CDW Corporation, Carousel Industries, and SHI International Corp. We also sell our solutions through carriers including AT&T, Inc. (“AT&T”), TELUS Communications Company (“TELUS”) and BT Group plc (“BT”). We intend to continue to foster this network and expand our network with other resellers. We also participate in more traditional forms of media advertising, such as radio and billboard advertising.

Since its launch, our revenue growth has primarily been driven by our flagship RingCentral Office product offering, which has resulted in an increased number of customers, increased average software subscription revenue per customer, and increased retention of our existing customer and user base. We define a “customer” as one individual billing relationship for the subscription to our services, which generally correlates to one company account per customer. As of September 30, 2018, we had customers from a range of industries, including financial services, healthcare, legal services, real estate, retail, technology, insurance, construction, hospitality, and state and local government, among others. For the three and nine months ended September 30, 2018 and 2017, the vast majority of our total revenues were generated in the U.S. and Canada, although we expect the percentage of our total revenues derived outside of the U.S. and Canada to grow as we continue to expand internationally.

The growth of our business and our future success depend on many factors, including our ability to expand our customer base to medium-sized and larger customers, continue to innovate, grow revenues from our existing customer base, expand our distribution channels, and scale internationally.

In January 2018, we closed a transaction with AT&T to allow us to transition the existing customer base for RingCentral Office@Hand solution sold by AT&T directly to us. Subsequently, in August 2018, we entered into a revised service agreement with AT&T under which AT&T will resume reselling our solutions.

While these areas represent significant opportunities for us, they also pose risks and challenges that we must address in order to sustain the growth of our business and improve our operating results. We have experienced significant growth in recent periods, with total revenues of $503.6 million and $380.4 million in the years ended December 31, 2017 and 2016, respectively, generating year-over-year increase of 32%. For the nine months ended September 30, 2018 and 2017, our total revenues were $485.0 million and $362.4 million, respectively, representing year-over-year increase of 33.8%. We have continued to make significant expenditures and investments, including those in sales and marketing, research and development, infrastructure and operations and incurred net losses of $4.2 million and $16.2 million in the years ended December 31, 2017 and 2016, respectively. Our net loss was $20.5 million and $4.1 million for the nine months ended September 30, 2018 and 2017, respectively.

Effective January 1, 2018, we adopted the requirements of Accounting Standards Update (“ASU”) 2014-09, Revenue from Contracts with Customers (Topic 606), using the full retrospective method as discussed in Note 2 of Part I, Item 1 of this Quarterly Report on Form 10-Q. All amounts and disclosures set forth in this Quarterly Report on Form 10-Q reflect these changes.

Key Business Metrics

In addition to United States generally accepted accounting principles (“U.S. GAAP”) and financial measures such as total revenues, gross margin and cash flows from operations, we regularly review a number of key business metrics to evaluate growth trends, measure our performance, and make strategic decisions. We discuss revenues and gross margin under “Results of Operations” and cash flow from operations under “Liquidity and Capital Resources” below. Other key business metrics are discussed below.

Annualized Exit Monthly Recurring Subscriptions

We believe that our Annualized Exit Monthly Recurring Subscriptions (“ARR”) is a leading indicator of our anticipated software subscriptions revenues. We believe that trends in revenue are important to understanding the overall health of our business, and we use these trends in order to formulate financial projections and make strategic business decisions. Our ARR equals our Monthly Recurring Subscriptions multiplied by 12. Our Monthly Recurring Subscriptions equals the monthly value of all customer recurring charges contracted at the end of a given month. For example, our Monthly Recurring Subscriptions at September 30, 2018 was $56.1 million. As such, our ARR at September 30, 2018 was $673.6 million.

RingCentral Office Annualized Exit Monthly Recurring Subscriptions

We calculate our RingCentral Office Annualized Exit Monthly Recurring Subscriptions (“Office ARR”) in the same manner as we calculate our ARR, except that only customer subscriptions from RingCentral Office customers are included when determining Monthly Recurring Subscriptions for the purposes of calculating this key business metric. RingCentral Office is our flagship product offering. We believe that trends in revenue with respect to RingCentral Office are also important to understanding the overall health of our business, and we use these trends in order to formulate financial projections and make strategic business decisions. Our Office ARR at September 30, 2018 was $591.7 million.

Net Monthly Subscription Dollar Retention Rate

We believe that our Net Monthly Subscription Dollar Retention Rate provides insight into our ability to retain and grow software subscriptions revenue, as well as our customers’ potential long-term value to us. We believe that our ability to retain our customers and expand their use of our solutions over time is a leading indicator of the stability of our revenue base and we use these trends in order to formulate financial projections and make strategic business decisions. We define our Net Monthly Subscription Dollar Retention Rate as (i) one plus (ii) the quotient of Dollar Net Change divided by Average Dollar Monthly Recurring Subscriptions.

We define Dollar Net Change as the quotient of (i) the difference of our Monthly Recurring Subscriptions at the end of a period minus our Monthly Recurring Subscriptions at the beginning of a period minus our Monthly Recurring Subscriptions at the end of the period from new customers we added during the period, (ii) all divided by the number of months in the period. We define our Average Monthly Recurring Subscriptions as the average of the Monthly Recurring Subscriptions at the beginning and end of the measurement period.

For example, if our Monthly Recurring Subscriptions were $118 at the end of a quarterly period and $100 at the beginning of the period, and $20 at the end of the period from new customers we added during the period, then the Dollar Net Change would be equal to ($0.67), or the amount equal to the difference of $118 minus $100 minus $20, all divided by three months. Our Average Monthly Recurring Subscriptions would equal $109, or the sum of $100 plus $118, divided by two. Our Net Monthly Subscription Dollar Retention Rate would then equal 99.4%, or approximately 99%, or one plus the quotient of the Dollar Net Change divided by the Average Monthly Recurring

Subscriptions.

Our key business metrics for the five quarterly periods ended September 30, 2018 were as follows (dollars in millions):

| | September 30, 2018 | June 30, 2018 | March 31, 2018 | December 31, 2017 | September 30, 2017 |
|---|---|---|---|---|---|
| Net Monthly Subscription Dollar Retention Rate | >99% | >99% | >99% | >99% | >99% |
| Annualized Exit Monthly Recurring Subscriptions | $ 673.6 | $629.6 | $589.0 | $ 546.4 | $ 513.7 |
| RingCentral Office Annualized Exit Monthly Recurring Subscriptions | $ 591.7 | $548.0 | $509.2 | $ 466.2 | $ 433.7 |

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Quarterly Revenue Trends

Our software subscriptions revenue is primarily driven by recurring subscription services. Historically, we have acquired more new customers in the first and third quarters of a fiscal year. However, we have seen this trend becoming increasingly less pronounced as our business has grown, sales of RingCentral Office have accounted for a higher percentage of our total revenues, and as we move up-market to target and acquire larger customers.

Quarterly Operating Expenses Trends

Operating expenses are primarily driven by employee-related expenses and by sales and marketing programs, and have been relatively consistent as a percentage of revenues. We expect this trend to continue as we acquire larger customers and expand globally.

Results of Operations

The following tables set forth selected condensed consolidated statements of operations data and such data as a percentage of total revenues. The historical results presented below are not necessarily indicative of the results that may be expected for any future period (in thousands):

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

| | | | | |
|---|---|---|---|---|
| Net (loss) income | $(9,518 ) | $269 | $(20,525 ) | $(4,083 ) |

* Adjusted for the adoption of Topic 606.

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Percentage of Total Revenues

| | Three Months Ended September 30, 2018 | Three Months Ended September 30, 2017 *As Adjusted | Nine Months Ended September 30, 2018 | Nine Months Ended September 30, 2017 *As Adjusted |
|---|---|---|---|---|
| Revenues | | | | |
| Software subscriptions | 91 % | 92 % | 91 % | 92 % |
| Other | 9 | 8 | 9 | 8 |
| Total revenues | 100 | 100 | 100 | 100 |
| Cost of revenues | | | | |
| Software subscriptions | 16 | 18 | 16 | 18 |
| Other | 7 | 6 | 7 | 6 |
| Total cost of revenues | 23 | 24 | 23 | 24 |
| Gross profit | 77 | 76 | 77 | 76 |
| Operating expenses | | | | |
| Research and development | 15 | 15 | 15 | 15 |
| Sales and marketing | 49 | 47 | 49 | 47 |
| General and administrative | 17 | 14 | 16 | 15 |
| Total operating expenses | 81 | 76 | 80 | 77 |
| Loss from operations | (4 ) | — | (3 ) | (1 ) |
| Other income (expense), net | | | | |
| Interest expense | (3 ) | — | (2 ) | — |
| Other income, net | 1 | — | 1 | — |
| Other (expense) income, net | (1 ) | — | (1 ) | — |
| (Loss) income before income taxes | (5 ) | — | (4 ) | (1 ) |
| Provision for income taxes | — | — | — | — |
| Net (loss) income | (5 )% | (— )% | (4 )% | (1 )% |

Comparison of the three and nine months ended September 30, 2018 and 2017

Revenues

| (in thousands, except percentages) | Three Months Ended September 30, 2018 | Three Months Ended September 30, 2017 *As Adjusted | $ Change | % Change | Nine Months Ended September 30, 2018 | Nine Months Ended September 30, 2017 *As Adjusted | $ Change | % Change |
|---|---|---|---|---|---|---|---|---|
| Revenues | | | | | | | | |
| Software subscriptions | $158,068 | $119,916 | $38,152 | 32 % | $440,987 | $334,942 | $106,045 | 32 |