Five9, Inc.
Form 10-Q
May 01, 2018

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

FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2018
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number: 001-36383

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

Delaware	94- 3394123
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

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

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: x No: o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes: x No: o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See 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	x	Accelerated Filer	o
Non-accelerated filer	o (Do not check if a smaller reporting Company)	Smaller Reporting Company	o
		Emerging Growth Company	o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. Yes: o No: o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes: o No: x

As of April 23, 2018, there were 57,683,899 shares of the Registrant’s common stock, par value $0.001 per share, outstanding.

FIVE9, INC.
FORM 10-Q
TABLE OF CONTENTS

Table of Contents

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

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

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

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

2

Table of Contents

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

Table of Contents

PART I. FINANCIAL INFORMATION
ITEM 1. Financial Statements
FIVE9, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)

	March 31, 2018 (Unaudited)	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 80,676	$ 68,947
Accounts receivable, net	18,534	19,048
Prepaid expenses and other current assets	7,150	4,840
Deferred contract acquisition costs	7,562	—
Total current assets	113,922	92,835
Property and equipment, net	20,876	19,888
Intangible assets, net	957	1,073
Goodwill	11,798	11,798
Other assets	1,120	2,602
Deferred contract acquisition costs — less current portion	17,238	—
Total assets	$ 165,911	$ 128,196
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 5,482	$ 4,292
Accrued and other current liabilities	14,132	11,787
Accrued federal fees	1,331	1,151
Sales tax liability	1,097	1,326
Notes payable	180	336
Capital leases	6,810	6,651
Deferred revenue	13,700	13,975
Total current liabilities	42,732	39,518
Revolving line of credit	32,594	32,594
Sales tax liability — less current portion	979	1,044
Capital leases — less current portion	7,654	7,161
Other long-term liabilities	1,500	1,041
Total liabilities	85,459	81,358
Commitments and contingencies (Note 10)		
Stockholders' equity:		
Preferred stock, $0.001 par value; 5,000 shares authorized, no shares issued and outstanding at March 31, 2018 and December 31, 2017	—	—
Common stock, $0.001 par value; 450,000 shares authorized, 57,654 shares and 56,632 shares issued and outstanding at March 31, 2018 and December 31, 2017, respectively	58	57
Additional paid-in capital	232,277	222,202
Accumulated deficit	(151,883)	(175,421)
Total stockholders' equity	80,452	46,838
Total liabilities and stockholders' equity	$ 165,911	$ 128,196

See accompanying notes to condensed consolidated financial statements.

Table of Contents

FIVE9, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
AND COMPREHENSIVE LOSS
(Unaudited, in thousands, except per share data)

	Three Months Ended	
	March 31, 2018	March 31, 2017
Revenue	$58,905	$47,014
Cost of revenue	24,702	19,971
Gross profit	34,203	27,043
Operating expenses:		
Research and development	7,772	6,847
Sales and marketing	17,478	15,778
General and administrative	9,103	8,860
Total operating expenses	34,353	31,485
Loss from operations	(150)	(4,442)
Other income (expense), net:		
Interest expense	(810)	(882)
Interest income and other	398	118
Total other income (expense), net	(412)	(764)
Loss before income taxes	(562)	(5,206)
Provision for income taxes	45	49
Net loss	$(607)	$(5,255)
Net loss per share:		
Basic and diluted	$(0.01)	$(0.10)
Shares used in computing net loss per share:		
Basic and diluted	56,399	53,688
Comprehensive Income (Loss):		
Net loss and comprehensive loss	$(607)	$(5,255)

See accompanying notes to condensed consolidated financial statements.

Table of Contents

FIVE9, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, in thousands)

	Three Months Ended	
	March 31, 2018	March 31, 2017
Cash flows from operating activities:		
Net loss	$(607)	$(5,255)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	2,320	2,095
Provision for doubtful accounts	48	24
Stock-based compensation	5,325	3,129
Gain on sale of convertible notes held for investment	(312)	—
Non-cash adjustment on investment	(40)	(103)
Amortization of debt discount and issuance costs	20	20
Accretion of interest	16	5
Others	(10)	(8)
Changes in operating assets and liabilities:		
Accounts receivable	519	(1,595)
Prepaid expenses and other current assets	(1,833)	(2,129)
Deferred contract acquisition costs	(1,662)	—
Other assets	(90)	30
Accounts payable	1,181	(95)
Accrued and other current liabilities	2,791	3,119
Accrued federal fees and sales tax liability	(115)	(11)
Deferred revenue	121	909
Other liabilities	325	24
Net cash provided by operating activities	7,997	159
Cash flows from investing activities:		
Purchases of property and equipment	(433)	(514)
Proceeds from sale of convertible notes held for investment	1,923	—
Net cash provided by (used in) investing activities	1,490	(514)
Cash flows from financing activities:		
Proceeds from exercise of common stock options	4,751	793
Payments of notes payable	(157)	(258)
Payments of capital leases	(2,352)	(1,850)
Net cash provided by (used in) financing activities	2,242	(1,315)
Net increase (decrease) in cash and cash equivalents	11,729	(1,670)
Cash and cash equivalents:		
Beginning of period	68,947	58,122
End of period	$80,676	$56,452
Supplemental disclosures of cash flow data:		
Cash paid for interest	$765	$840
Cash paid for income taxes	$33	$21
Non-cash investing and financing activities:		
Equipment obtained under capital lease	$2,635	$2,603
Equipment purchased and unpaid at period-end	$281	$159

See accompanying notes to condensed consolidated financial statements.

Table of Contents

FIVE9, INC.
Notes to Condensed Consolidated Financial Statements (Unaudited)
1. Description of Business and Summary of Significant Accounting Policies
Five9, Inc. and its wholly-owned subsidiaries (the “Company”) is a provider of cloud software for contact centers. The Company was incorporated in Delaware in 2001 and is headquartered in San Ramon, California. The Company has offices in Europe and Asia, which primarily provide research, development, sales, marketing, and client support services.
Basis of Presentation
The accompanying condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (“GAAP”) and applicable rules and regulations of the Securities and Exchange Commission (“SEC”) regarding interim financial reporting. Certain information and note disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. Therefore, these condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017. In the opinion of management, the condensed consolidated financial statements reflect all adjustments, which are normal and recurring in nature, necessary for fair financial statement presentation. All intercompany transactions and balances have been eliminated in consolidation.
Certain prior period amounts included in the condensed consolidated financial statements have been reclassified to conform to the current period presentation.
Use of Estimates
The preparation of condensed consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. The significant estimates made by management affect revenue, the allowance for doubtful accounts, loss contingencies, including the Company’s accrual for federal fees and sales tax liability, and accrued liabilities. Management periodically evaluates such estimates and they are adjusted prospectively based upon such periodic evaluation. Actual results could differ from those estimates.
Significant Accounting Policies
The Company’s significant accounting policies are disclosed in its Annual Report on Form 10-K for the year ended December 31, 2017. Other than the accounting policies discussed in Note 2 related to the adoption of ASC 606, there has been no material change to the Company’s significant accounting policies during the three months ended March 31, 2018. See Note 2 for the updated accounting policies.
Recently Adopted Accounting Pronouncements
In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standard Update (“ASU”) 2014-09, Revenue from Contracts with Customers: Topic 606, amending revenue recognition guidance and requiring more detailed disclosures to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. ASU 2014-09 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. The Company adopted ASU 2014-09 and its related amendments (collectively “ASC 606”) effective on January 1, 2018 using the modified retrospective method. See Note 2 for disclosure on the impact of adopting this standard.
Recent Accounting Pronouncements Not Yet Effective
In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). Under the new guidance, a lessee will be required to recognize assets and liabilities for both finance, or capital, and operating leases with lease terms of more than 12 months. The ASU also will require disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. Lessor accounting will

7

Table of Contents

remain largely unchanged from current GAAP. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach that includes a number of optional practical expedients that entities may elect to apply. This guidance is effective for the Company beginning in the first quarter of 2019. Early adoption is permitted. The Company is currently gathering information and evaluating the impact this guidance will have on its consolidated financial statements.

There are several other new accounting pronouncements issued by the FASB, which the Company will adopt. However, the Company does not believe any of those accounting pronouncements will have a material impact on its consolidated financial position, operating results or statements of cash flows.

2. ASC 606 Adoption Impact and Revenue from Contracts with Customers

ASC 606 Adoption Impact

On January 1, 2018, the Company adopted ASC 606 using the modified retrospective method, applying to all contracts. The Company recognized the cumulative effect of applying the new revenue standard as an adjustment to the opening balance of accumulated deficit at the beginning of 2018. The comparative information has not been restated and continues to be reported under the accounting standards in effect for the period presented, or “ASC 605.” In connection with the adoption of ASC 606, the Company also adopted ASC 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 ASC 606 and ASC 340-40 as the "new standard.”

Adoption of the new standard resulted in changes to our accounting policies for revenue recognition, commissions and deferred commissions as discussed below. The Company recorded a net reduction to opening accumulated deficit of $24.1 million as of January 1, 2018 due to the cumulative impact of adopting the new standard. The primary impact of adopting the new standard relates to the deferral of $23.1 million in incremental commission costs of obtaining subscription contracts. Under ASC 605, the Company expensed all commission costs as incurred. Under the new standard, the Company defers all incremental commission costs to obtain the contract, and amortizes these costs over a period of benefit determined to be five years. The remaining $1.0 million impact of adopting the standard relates to revenue being recognized earlier than it would have been under ASC 605.

Practical Expedients and Exemptions

The Company applies a practical expedient that permits the Company to apply Subtopic 340-40 to a single portfolio of contracts, as they are similar in their characteristics, and the financial statement effects of applying Subtopic 340-40 to that portfolio would not differ materially from applying it to the individual contracts within that portfolio.

Additionally, the Company applies a practical expedient of including the remaining value of unsatisfied performance obligations that exist within contracts with original terms of greater than one year.

Impact on the condensed consolidated financial statements

Select condensed consolidated balance sheet line items, which reflects the adoption impact of the new standard, are as follows:

	March 31, 2018		
(in thousands)	As Reported	Balances without adoption of ASC 606	Effect of Change Higher (Lower)
Assets:			
Accounts receivable, net	$18,534	$18,431	$ 103
Prepaid expenses and other current assets	7,150	6,849	301
Deferred contract acquisition costs	24,800	—	24,800
Liabilities:			
Deferred revenue - current	13,700	14,811	(1,111)
Shareholders' Equity:			
Accumulated deficit	(151,883)	(178,198)	26,315

Table of Contents

Select condensed consolidated statement of operations line items, which reflects the adoption of the new standard, are as follows:

(in thousands, except per share amounts)	Three months ended March 31, 2018		
	As Reported	Balances without adoption of ASC 606	Effect of Change Higher (Lower)
Revenue	$58,905	$58,152	$ 753
Cost of revenue	24,702	24,457	245
Gross profit	34,203	33,695	508
Sales and marketing	17,478	19,140	(1,662)
Loss from operations	(150)	(2,320)	2,170
Net loss	(607)	(2,777)	2,170
Basic and diluted net loss per share	$(0.01)	$(0.05)	$ 0.04

Select condensed consolidated cash flow line items, which reflects the adoption of the new standard, are as follows:

(in thousands)	Three months ended March 31, 2018		
	As Reported	Balances without adoption of ASC 606	Effect of Change Higher (Lower)
Accounts receivable	$519	$ 622	$ (103)
Prepaid expenses and other current assets	(1,833)	(1,532)	(301)
Deferred contract acquisition costs	(1,662)	—	(1,662)
Deferred revenue	121	1,232	(1,111)
Net cash provided by operating activities	7,997	7,997	—

Changes in Accounting Policies

Revenue Recognition

Revenue is recognized when control of the promised services are transferred to customers, in an amount that reflects the consideration that the Company expects to receive in exchange for those services. The Company generates all of its revenue from contracts with customers. In contracts with multiple performance obligations, it identifies each performance obligation and evaluates whether the performance obligations are distinct within the context of the contract at contract inception. Performance obligations that are not distinct at contract inception are combined. The Company allocates the transaction price to each distinct performance obligation proportionately based on the estimated standalone selling price for each performance obligation. The Company then looks to how services are transferred to the customer in order to determine the timing of revenue recognition. Most services provided under the Company’s agreements result in the transfer of control over time.

The Company’s revenue consists of subscription services and related usage as well as professional services. The Company charges clients subscription fees, usually billed on a monthly basis, for access to the Company’s VCC solution. The monthly subscription fees are primarily based on the number of agent seats, as well as the specific VCC functionalities and applications deployed by the client. Agent seats are defined as the maximum number of named agents allowed to concurrently access the VCC cloud platform. Clients typically have more named agents than agent seats. Multiple named agents may use an agent seat, though not simultaneously. Substantially all of the Company’s clients purchase both subscriptions and related telephony usage. A small percentage of the Company's clients subscribe to its platform but purchase telephony usage directly from a wholesale telecommunications service provider. The Company does not sell telephony usage on a stand-alone basis to any client. The related usage fees are based on the volume of minutes used for inbound and outbound client interactions. The Company also offers bundled plans, generally for smaller deployments, whereby the client is charged a single monthly fixed fee per agent seat that includes both subscription and unlimited usage in the contiguous 48 states and, in some cases, Canada. Professional services revenue is derived primarily from VCC implementations, including application configuration, system integration, optimization, education and training services. Clients are not permitted to take possession of the Company’s software.

Table of Contents

The Company offers monthly, annual and multiple-year contracts to its clients, generally with 30 days' notice required for changes in the number of agent seats and sometimes with a minimum number of agent seats required. Larger clients typically choose annual contracts, which generally include an implementation and ramp period of several months. Fixed subscription fees (including bundled plans) are generally billed monthly in advance, while related usage fees are billed in arrears. Support activities include technical assistance for the Company's solution and upgrades and enhancements to the VCC cloud platform on a when-and-if-available basis, which are not billed separately.
The Company generally requires advance deposits from its clients based on estimated usage when such usage is not billed as part of a bundled plan. Any unused portion of the deposit is refundable to the client upon termination of the arrangement, provided all amounts due have been paid. All fees, except usage deposits, are non-refundable
Professional services are primarily billed on a fixed-fee basis and are performed by the Company directly or, alternatively, clients may also choose to perform these services themselves or engage their own third-party service providers.
The estimation of variable consideration for each performance obligation requires us to make some subjective judgments. In the early stages of our larger contracts, the Company must estimate variable consideration to be included in the transaction fee, to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved, in order to allocate the overall transaction fee on a relative stand-alone selling price basis to its multiple performance obligations. This requires the estimate of unit quantities, especially during the initial ramp period of the contract, during which the Company bills under an 'actual usage' model for subscription-related services.
The Company recognizes revenue on fixed fee professional services performance obligations based on the proportion of labor hours expended compared to the total hours expected to complete the related performance obligation. The determination of the total labor hours expected to complete the performance obligations involves some judgment, influencing the initial stand-alone selling price estimate as well as the timing of professional services revenue recognition, although this uncertainty is typically resolved in a short time frame.

When a contract with a customer is signed, the Company assesses whether collection of the fees under the arrangement is probable. The Company assesses collection based on a number of factors, including past transaction history and the creditworthiness of the client. The Company maintains a revenue reserve for potential credits to be issued in accordance with service level agreements or for other revenue adjustments.
The revenue recognition standards include guidance relating to any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer and may include, but is not limited to, sales, use, value added and excise taxes. The Company records Universal Service Fund, or USF, contributions and other regulatory costs on a gross basis in its consolidated statements of operations and comprehensive loss and records surcharges and sales, use and excise taxes billed to its clients on a net basis. The cost of gross USF contributions payable to the Universal Service Administrative Company, or USAC, and suppliers is presented as a cost of revenue in the condensed consolidated statements of operations and comprehensive loss. Surcharges and sales, use and excise taxes incurred in excess of amounts billed to the Company's clients are presented in general and administrative expense in the condensed consolidated statements of operations and comprehensive loss.

Table of Contents

Disaggregation of Revenue

The Company disaggregates its revenue by geographic region. See Note 11 for more information.

Contract Balances

The following table provides information about receivables, contract assets and contract liabilities from contracts with customers (in thousands):

	March 31, 2018
Receivables	$ 18,534
Deferred contract acquisition costs	24,800
Short-term contract assets	785
Short-term contract liabilities (deferred revenue)	13,700

The Company receives payments from customers based upon billing cycles. Invoice payment terms are usually 30 days or less. Accounts receivable are recorded when the right to consideration becomes unconditional.

Deferred contract acquisition costs are recorded when incurred and are amortized over a customer benefit period of five years.

Contract assets include amounts related to the Company’s contractual right to consideration for performance obligations not yet invoiced and is included in prepaid and other current assets in the condensed consolidated balance sheets. The Company had no asset impairment charges related to contract assets in the period.

Contract liabilities are comprised of amounts billed in advance of performance under the contract, and are realized with the associated revenue recognized under the contract.

Significant changes in the contract assets and the contract liabilities balances during the period are as follows (in thousands):

	Three Months Ended March 31, 2018	
	Contract Assets Increase (Decrease)	Contract Liabilities Increase (Decrease)(1)
Revenue recognized that was included in the contract liability (deferred revenue) balance at January 1, 2018	$ —	$ (6,440)
Increase, due	—	6,572

to invoicing in current period, excluding amounts recognized as revenue during the period

Transferred to receivables from contract assets recognized at January 1, 2018	(86)	—
Additional contract assets recognized, net of reclassification to receivables	135	—
Performance obligations satisfied in previous periods (transition adjustment)	736	(407)

(1) Comprised of deferred revenue

Deferred Contract Acquisition Costs

In connection with the adoption of ASC 340-40, the Company is required to capitalize certain contract acquisition costs consisting primarily of commissions paid when contracts are signed and related incremental fringe benefits. As of January 1, 2018, the date of ASC 340-40 adoption, the Company had $23.1 million capitalized in deferred contract acquisition costs related to contracts where the benefit period had not yet expired. In the three months ended March 31, 2018, amortization from amounts capitalized was $1.9 million and amounts expensed as incurred was $0.5 million. The Company had no impairment loss in relation to costs capitalized.

Table of Contents

Remaining Performance Obligations

As of March 31, 2018, the aggregate amount of the total transaction price allocated in contracts with original duration of greater than one year to the remaining performance obligations was $56.5 million. The Company expects to recognize revenue on approximately three-quarters of the remaining performance obligation over the next 24 months, with the balance recognized thereafter. The Company has elected the optional exemption which allows for the exclusion of the amounts for remaining performance obligations that are part of contracts with an original expected duration of one year or less. Such remaining performance obligations represent the unsatisfied or partially unsatisfied performance obligations pursuant to ASC 606.

3. Fair Value Measurements

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

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

Level 2 — Observable inputs other than Level 1 inputs, such as quoted prices for similar assets, quoted prices for identical or similar assets in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset.

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

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

	March 31, 2018		
	Total	Level 1	Level 3
Assets			
Cash equivalents			
Money market funds	$20,132	$20,132	$—
Other Assets			
Embedded conversion option held for investment	$—	$—	$—

	December 31, 2017		
	Total	Level 1	Level 3
Assets			
Cash equivalents			
Money market funds	$20,092	$20,092	$—
Other Assets			
Embedded conversion option held for investment	$984	$—	$984

In March 2018, the Company received proceeds of $1.9 million from the conversion and sales of convertible notes with carrying value of $1.6 million. Proceeds from the sale of the investment total $2.1 million. The Company expects to receive the remainder of the proceeds in 2019.

There were no assets or liabilities measured at fair value on a non-recurring basis as of March 31, 2018.

Table of Contents

4. Financial Statement Components

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

	March 31, 2018	December 31, 2017
Cash	$ 60,544	$ 48,855
Money market funds	20,132	20,092
Cash and cash equivalents	$ 80,676	$ 68,947

As of March 31, 2018, the Company was required to maintain $25.0 million of unrestricted cash and cash equivalents deposited with two lenders in connection with its credit agreement as a compensating balance. See Note 6.

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

	March 31, 2018	December 31, 2017
Trade accounts receivable	$ 16,678	$ 17,481
Unbilled trade accounts receivable, net of advance client deposits	1,884	1,600
Allowance for doubtful accounts	(28)	(33)
Accounts receivable, net	$ 18,534	$ 19,048

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

	March 31, 2018	December 31, 2017
Prepaid expenses	$ 4,431	$ 2,437
Other current assets	1,934	2,403
Contract assets	785	—
Prepaid expenses and other current assets	$ 7,150	$ 4,840

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

	March 31, 2018	December 31, 2017
Computer and network equipment	$ 49,780	$ 47,195
Computer software	7,387	6,974
Internal-use software development costs	500	500
Furniture and fixtures	1,433	1,282
Leasehold improvements	817	801
Property and equipment	59,917	56,752
Accumulated depreciation and amortization	(39,041)	(36,864)
Property and equipment, net	$ 20,876	$ 19,888

Depreciation and amortization expense associated with property and equipment was $2.2 million and $2.0 million for the three months ended March 31, 2018 and 2017, respectively.

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

	March 31, 2018	December 31, 2017
Gross	$ 49,167	$ 46,624
Less: accumulated depreciation and amortization	(32,149)	(30,438)
Total	$ 17,018	$ 16,186

13

Table of Contents

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

	March 31, 2018	December 31, 2017
Accrued compensation and benefits	$ 11,153	$ 8,657
Accrued expenses	2,979	3,130
Accrued and other current liabilities	$ 14,132	$ 11,787

5. Intangible Assets

The components of intangible assets were as follows (in thousands):

	March 31, 2018			December 31, 2017		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	$2,460	$ (1,565)	$ 895	$2,460	$ (1,478)	$ 982
Customer relationships	520	(463)	57	520	(437)	83
Domain names	50	(45)	5	50	(42)	8
Total	$3,030	$ (2,073)	$ 957	$3,030	$ (1,957)	$ 1,073

Amortization expense for intangible assets was $0.1 million for each of the three months ended March 31, 2018 and 2017.

As of March 31, 2018, the expected future amortization expense for intangible assets was as follows (in thousands):

Period	Expected Future Amortization Expense
2018	$ 326
2019	351
2020	280
Total	$ 957

6. Debt

2016 Loan and Security Agreement

On August 1, 2016, or the Effective Date, the Company entered into a loan and security agreement, or the 2016 Loan and Security Agreement, with the lenders party thereto and City National Bank, as agent for such lenders. The 2016 Loan and Security Agreement provides for a revolving line of credit, or the Revolving Credit Facility, of up to $50.0 million and matures on August 1, 2019. On the Effective Date, the Company borrowed $32.6 million under the 2016 Loan and Security Agreement. The proceeds were used to extinguish existing indebtedness under all prior Loan and Security Agreements and for working capital and other general corporate purposes.

Loans under the 2016 Loan and Security Agreement bear a variable annual interest rate of the prime rate plus 0.50%, subject to a 0.25% increase if the Company’s adjusted EBITDA is negative at the end of any fiscal quarter. The Company has agreed to pay a fee of 0.25% per annum on the unused portion of the Revolving Credit Facility as well as an anniversary fee of $31,250 on each of the first and second anniversaries of the Effective Date. The Company is accreting the total estimation of unused fees and anniversary fees evenly over the full term of the 2016 Loan and Security Agreement. Under the terms of the 2016 Loan and Security Agreement, the outstanding balance cannot exceed the Company’s trailing four months of MRR (monthly recurring revenue including subscription and usage) multiplied by the average trailing 12 month dollar based retention rate (calculated on the same basis as in the Company’s periodic reports filed with the SEC). As of March 31, 2018, the outstanding principal balance under the

14

Table of Contents

2016 Loan and Security Agreement was $32.6 million, which is included in 'Revolving line of credit' in the condensed consolidated balance sheets. As of March 31, 2018, the amount available for additional borrowings was $17.4 million. The Company incurred approximately $0.2 million in fees that were directly attributable to the issuance of this credit facility. These costs are deferred and included within 'Prepaid expenses and other current assets' and 'Other assets' in the Company's condensed consolidated balance sheets and being amortized to interest expense on a straight-line basis over three years starting from the Effective Date of the Revolving Credit Facility.

The obligations of the Company under the 2016 Loan and Security Agreement are guaranteed by the Company's subsidiary, Five9 Acquisition. The Company's obligations under the 2016 Loan and Security Agreement and Five9 Acquisition's obligations under its guaranty are secured by a first priority perfected security interest in and lien on substantially all of the Company's and Five9 Acquisition's assets. The 2016 Loan and Security Agreement contains certain customary covenants, including the requirement that the Company maintain $25.0 million of unrestricted cash deposited with the lenders for the term of the agreement, a minimum liquidity ratio of unrestricted cash and accounts receivable to the outstanding amounts under the 2016 Loan and Security Agreement, as well as customary events of default. Under the 2016 Loan and Security Agreement, the Company is also prohibited from declaring dividends or making other distributions on capital stock. The Company was in compliance with these covenants as of March 31, 2018.

FCC Civil Penalty

In June 2015, the Company entered into a consent decree with the Federal Communications Commission, or FCC, Enforcement Bureau, in which the Company agreed to pay a civil penalty of $2.0 million to the U.S. Treasury in twelve equal quarterly installments starting in July 2015 without interest. As a result, the Company discounted the $2.0 million liability, which was accrued in the third quarter of 2014 for the then tentative civil penalty, to its present value of $1.7 million at an annual interest rate of 12.75% to reflect the imputed interest and reclassified this discounted liability from 'Accrued federal fees' to 'Notes payable.' The $0.3 million discount was recorded as a reduction to general and administrative expense in the three months ended June 30, 2015 and is being recognized as interest expense over the payment term of the civil penalty. As of March 31, 2018 and December 31, 2017, the outstanding civil penalty payable was $0.2 million and $0.3 million, respectively, of which the net carrying value was $0.2 million and $0.3 million, respectively, and is included as 'Notes payable' in the accompanying condensed consolidated balance sheets.

As of March 31, 2018 and December 31, 2017, the Company's outstanding debt is summarized as follows (in thousands):

	March 31, 2018	December 31, 2017
Note payable - FCC civil penalty, gross	$ 167	$ 333
Less: discount	(1)	(7)
Note payable, net carrying value	166	326
Revolving line of credit	32,594	32,594
Interest accretion under 2016 line of credit	14	10
Total debt, net carrying value	$ 32,774	$ 32,930
Less: current portion of debt *	$ (180)	$ (336)
Total debt, less current portion **	$ 32,594	$ 32,594

* Included in 'Notes payable' in the condensed consolidated balance sheets.

** Included 'Revolving line of credit' in the condensed consolidated balance sheets.

Maturities of the Company's outstanding debt as of March 31, 2018 are as follows (in thousands):

Period

	Amount to Mature
2018	$167
2019	32,594
Total	$32,761

15

Table of Contents

7. Stockholders' Equity
Capital Structure
The Company is authorized to issue 450,000,000 shares of common stock with a par value of $0.001 per share. As of March 31, 2018 and December 31, 2017, the Company had 57,653,677 and 56,631,647 shares of common stock issued and outstanding, respectively.
The Company is also authorized to designate and issue up to 5,000,000 shares of preferred stock with a par value of $0.001 per share in one or more series without stockholder approval and to fix the rights, preferences, privileges and restrictions thereof. As of March 31, 2018 and December 31, 2017, the Company had no shares of preferred stock issued and outstanding.
Warrants
As of March 31, 2018 and December 31, 2017, the Company had outstanding warrants to purchase 13,013 shares of common stock with a weighted-average exercise price of $5.76 per share. The warrants outstanding as of March 31, 2018 will expire on October 18, 2023.
Common Stock Reserved for Future Issuance
Shares of common stock reserved for future issuance related to outstanding equity awards, common stock warrants, and employee equity incentive plans were as follows (in thousands):

	March 31, 2018
Stock options outstanding	3,491
Restricted stock units outstanding	2,427
Shares available for future grant under 2014 Plan	9,272
Shares available for future issuance under ESPP	1,937
Common stock warrants outstanding	13
Total shares of common stock reserved	17,140

Equity Incentive Plans
Prior to its initial public offering ("IPO"), the Company granted stock options under its Amended and Restated 2004 Equity Incentive Plan, as amended (the "2004 Plan").
In March 2014, the Company's board of directors and stockholders approved the 2014 Equity Incentive Plan ("2014 Plan") and 5,300,000 shares of common stock were reserved for issuance under the 2014 Plan. In addition, on the first day of each year beginning in 2015 and ending in 2024, the 2014 Plan provides for an annual automatic increase to the shares reserved for issuance in an amount equal to 5% of the total number of shares outstanding on December 31st of the preceding calendar year or a lesser number as determined by the Company's board of directors. Pursuant to the automatic annual increase, 2,831,582 additional shares were reserved under the 2014 Plan on January 1, 2018.
No further grants were made under the 2004 Plan once the 2014 Plan became effective on April 3, 2014. Upon the effectiveness of the 2014 Plan, all shares reserved for future issuance under the 2004 Plan became available for issuance under the 2014 Plan. After the IPO, any forfeited or expired shares that would have otherwise returned to the 2004 Plan instead return to the 2014 Plan.
The 2004 Plan and the 2014 Plan are described in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

Table of Contents

Stock Options

A summary of the Company’s stock option activity during the three months ended March 31, 2018 is as follows (in thousands, except years and per share data):

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Outstanding as of December 31, 2017	4,047	$ 8.00		
Options granted (weighted average grant date fair value of $14.02 per share)	237	30.08		
Options exercised	(786)	6.04		
Options forfeited or expired	(7)	4.71		
Outstanding as of March 31, 2018	3,491	$ 9.95	6.5	$ 69,323

The Company has computed the aggregate intrinsic value amounts disclosed in the above table based on the difference between the exercise price of the options and the closing market price of the Company’s common stock of $29.79 per share as of March 31, 2018 for all in-the-money options outstanding.

Restricted Stock Units

A summary of the Company’s restricted stock unit (“RSU”) activity during the three months ended March 31, 2018 is as follows (in thousands, except per share data):

	Number of Shares	Weighted Average Grant Date Fair Value Per Share
Outstanding as of December 31, 2017	2,033	$ 7.65
RSUs granted	656	29.48
RSUs vested and released	(236)	10.02
RSUs forfeited	(26)	14.32
Outstanding as of March 31, 2018	2,427	$ 17.56

Employee Stock Purchase Plan

The Company’s 2014 Employee Stock Purchase Plan (“ESPP”) became effective on April 3, 2014 and is described in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017. The number of shares of common stock originally reserved for issuance under the ESPP was 880,000 shares, which will increase automatically each year, beginning on January 1, 2015 and continuing through January 1, 2024, by the lesser of (i) 1% of the total number of shares of the Company’s common stock outstanding on December 31 of the preceding calendar year; (ii) 1,000,000 shares of common stock (subject to adjustment to reflect any split or combination of the Company’s common stock); or (iii) such lesser number as determined by the Company’s board of directors. Pursuant to the automatic annual increase, 566,316 additional shares were reserved under the ESPP on January 1, 2018.

During the three months ended March 31, 2018, no shares were purchased under the ESPP.

Table of Contents

Stock-Based Compensation

Stock-based compensation expenses for the three months ended March 31, 2018 and 2017 were as follows (in thousands):

	Three Months Ended	
	March 31, 2018	March 31, 2017
Cost of revenue	$678	$ 434
Research and development	877	637
Sales and marketing	1,362	928
General and administrative	2,408	1,130
Total stock-based compensation	$5,325	$ 3,129

As of March 31, 2018, unrecognized stock-based compensation expenses by award type and their expected weighted-average recognition periods are summarized in the following table (in thousands, except years).

	Stock Option	RSU	ESPP
Unrecognized stock-based compensation expense	$12,467	$41,974	$220
Weighted-average amortization period	2.7 years	3.2 years	0.1 years

The Company recognizes stock-based compensation expense that is calculated based upon awards that have vested, reduced for actual forfeitures. All stock-based compensation for equity awards granted to employees and non-employee directors is measured based on the grant date fair value of the award.

The Company values RSUs at the closing market price of its common stock on the date of grant. The Company estimates the fair value of each stock option and purchase right under the ESPP granted to employees on the date of grant using the Black-Scholes option-pricing model and using the assumptions noted in the below table. The weighted-average assumptions used to value stock options granted during the three months ended March 31, 2018 and 2017 were as follows:

Stock Options	Three Months Ended	
	March 31, 2018	March 31, 2017
Expected term (years)	6.0	6.0
Volatility	45 %	49 %
Risk-free interest rate	2.7%	2.0 %
Dividend yield (1)	—	—

(1) The Company has not paid, and does not anticipate paying, cash dividends on its shares of common stock. Accordingly, the expected dividend yield is zero.

8. Net Loss Per Share

Basic net loss per share is calculated by dividing net loss by the weighted average number of common shares outstanding during the period, and excludes any dilutive effects of employee stock-based awards and warrants. As the Company had net losses for the three months ended March 31, 2018 and 2017, all potentially issuable common shares were determined to be anti-dilutive.

Table of Contents

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

	Three Months Ended	
	March 31, 2018	March 31, 2017
Net loss	$(607)	$(5,255)
Weighted-average shares of common stock outstanding	56,399	53,688
Basic and diluted net loss per share	$(0.01)	$(0.10)

The following securities were excluded from the calculation of diluted net loss per share because their effect would have been anti-dilutive (in thousands).

	March 31, 2018	March 31, 2017
Stock options	3,491	5,127
Restricted stock units	2,427	2,607
Common stock warrants	13	13
Total	5,931	7,747

9. Income Taxes

The provision for income taxes for the three months ended March 31, 2018 and 2017 was approximately $45 thousand and $49 thousand, respectively. The provision for income taxes consisted primarily of foreign income taxes.

For the three months ended March 31, 2018 and 2017, the provision for income taxes differed from the statutory amount primarily due to the Company realizing no benefit for current year losses due to maintaining a full valuation allowance against its domestic net deferred tax assets.

The realization of tax benefits of deferred tax assets is dependent upon future levels of taxable income, of an appropriate character, in the periods the items are expected to be deductible or taxable. Based on the available objective evidence, the Company does not believe it is more likely than not that the net deferred tax assets will be realizable. Accordingly, the Company has provided a full valuation allowance against the domestic net deferred tax assets as of March 31, 2018 and December 31, 2017. The Company intends to maintain the remaining valuation allowance until sufficient positive evidence exists to support a reversal of, or decrease in, the valuation allowance.

During the three months ended March 31, 2018, there were no material changes to the total amount of unrecognized tax benefits.

10. Commitments and Contingencies

Commitments

The Company’s principal commitments consist of future payment obligations under capital leases to finance data centers and other computer and networking equipment purchases, debt agreements (see Note 6), operating lease agreements for office space, research and development, and sales and marketing facilities, and agreements with third parties to provide co-location hosting, telecommunication usage and equipment maintenance services. These commitments as of December 31, 2017 are disclosed in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017, and did not change materially during the three months ended March 31, 2018 except for the acquisition of certain additional data center and network equipment and software under multiple capital leases, and certain hosting and telecommunications agreements. As of March 31, 2018, the total minimum future payment commitments under these capital leases added during the three months ended March 31, 2018 were approximately $3.7 million, of which $1.1 million is due during the remainder of 2018, with the remaining $2.6 million due in 2019 to 2021.

During the three months ended March 31, 2018, the Company entered into various hosting and telecommunications agreements for terms of 12 to 36 months commencing on various dates in 2018. These

Table of Contents

agreements require the Company to make monthly payments over the service term in exchange for certain network services. The Company's total minimum future payment commitments under these agreements are $2.1 million.

Universal Services Fund Liability

During the third quarter of 2012, the Company determined that based on its business activities, it is classified as a telecommunications service provider for regulatory purposes and it should make direct contributions to the federal USF and related funds based on revenues it receives from the resale of interstate and international telecommunications services. In order to comply with the obligation to make direct contributions, the Company made a voluntary self-disclosure to the FCC Enforcement Bureau and registered with the USAC, which is charged by the FCC with administering the USF. The Company filed exemption certificates with its wholesale telecommunications service providers in order to eliminate its obligation to reimburse such wholesale telecommunications service providers for their USF contributions calculated on services sold to the Company. In April 2013, the Company began remitting required contributions on a prospective basis directly to USAC.

The Company's registration with USAC subjects it to assessments for unpaid USF contributions, as well as interest thereon and civil penalties, due to its late registration and past failure to recognize its obligation as a USF contributor and as an international carrier. The Company is required to pay assessments for periods prior to the Company's registration. As of December 31, 2012, the total past due USF contribution being imposed by USAC and accrued by the Company for the period from 2003 through 2012 was $8.1 million, of which $4.7 million was undisputed and $3.4 million was disputed. The Company subsequently updated its filings and increased the liability related to 2008 through 2012 by $0.5 million, arriving at a new total of $3.9 million in disputed liability. In July 2013, the Company and USAC agreed to a financing arrangement for $4.1 million of the undisputed $4.7 million of the unpaid USF contributions whereby the Company issued to USAC a promissory note payable in the principal amount of the $4.1 million and paid off the remaining undisputed $0.6 million. The Company had fully paid the promissory note as of January 2017.

In January 2017, the FCC's Wireline Competition Bureau ruled in the Company's favor with respect to most of the disputed amount. In September 2017, USAC issued a credit to the Company reflecting the FCC's ruling for the $3.1 million of the $3.9 million in disputed liability. In addition, USAC reversed the interest and penalties related to the disputed liability of $3.1 million. The remaining $0.8 million in dispute involves USAC's assessment of liability for the period of 2003 through 2007, which was prior to the five year window during which the Company was required to maintain financial records for USF contribution purposes. The Company filed a Request for Review (a form of appeal) of this disputed amount with the FCC's Wireline Competition Bureau in 2013, which remains pending. If the Request for Review is not resolved in the Company's favor, it is possible that the Company will be held to the back assessments of $0.8 million, which includes interest and penalties on that amount.

As of March 31, 2018, the accrued liability on the remaining disputed assessments, including interest and penalties for the period of 2003 through 2007, was $0.8 million offset by $0.7 million in other USF credits.

State and Local Taxes and Surcharges

In April 2012, the Company commenced collecting and remitting sales taxes on sales of subscription services in all the U.S. states in which it determined it was obligated to do so. During the first quarter of 2015, the Company conducted an updated sales tax review of the taxability of sales of its subscription services. As a result, the Company determined that it may be obligated to collect and remit sales taxes on such sales in four additional states. Based on its best estimate of the probable sales tax liability in those four states relating to its sales of subscription services during the period 2011 through 2014, during the three months ended March 31, 2015, the Company recorded a general and administrative expense of $0.6 million to accrue for such taxes.