

Cornerstone OnDemand Inc  
Form 10-Q  
August 03, 2017

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

Form 10-Q  
(Mark One)

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

For the quarterly period ended June 30, 2017

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 001-35098

Cornerstone OnDemand, Inc.  
(Exact name of registrant as specified in its charter)  
Delaware 13-4068197  
(State or other jurisdiction of (IRS Employer  
incorporation or organization) Identification No.)  
1601 Cloverfield Blvd.  
Suite 620 South  
Santa Monica, CA 90404  
(Address of principal executive offices, including zip code)  
Registrant's telephone number, including area code:  
(310) 752-0200

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a 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  (Do not check if a smaller reporting company) 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. Yes  No

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date

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Class	Outstanding as of July 31, 2017
Common Stock	57,579,020

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 QUARTERLY REPORT ON FORM 10-Q  
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## PART I. FINANCIAL INFORMATION

## ITEM 1. Condensed Consolidated Financial Statements

CORNERSTONE ONDEMAND, INC.  
 CONDENSED CONSOLIDATED BALANCE SHEETS  
 (in thousands, except par values)  
 (unaudited)

	June 30, 2017	December 31, 2016
Assets		
Cash and cash equivalents	\$ 107,002	\$ 83,300
Short-term investments	202,952	218,791
Accounts receivable, net	119,166	136,657
Deferred commissions	34,968	36,298
Prepaid expenses and other current assets	23,807	18,467
Total current assets	487,895	493,513
Capitalized software development costs, net	35,915	30,683
Property and equipment, net	22,946	23,962
Long-term investments	19,022	41,046
Intangible assets, net	2,986	7,421
Goodwill	25,894	25,894
Other assets, net	2,741	1,110
Total Assets	\$ 597,399	\$ 623,629
Liabilities and Stockholders' Equity		
Liabilities:		
Accounts payable	\$ 13,467	\$ 24,392
Accrued expenses	41,124	47,619
Deferred revenue, current portion	254,279	272,206
Convertible notes, net	243,171	—
Other liabilities	5,551	2,094
Total current liabilities	557,592	346,311
Convertible notes, net	—	238,435
Other liabilities, non-current	1,663	1,794
Deferred revenue, net of current portion	8,587	10,126
Total liabilities	567,842	596,666
Commitments and contingencies (Note 9)		
Stockholders' Equity:		
Common stock, \$0.0001 par value; 1,000,000 shares authorized, 57,177 and 56,516 shares issued and outstanding at June 30, 2017 and December 31, 2016, respectively	6	6
Additional paid-in capital	518,418	476,230
Accumulated deficit	(491,195 )	(453,719 )
Accumulated other comprehensive income	2,328	4,446
Total stockholders' equity	29,557	26,963
Total Liabilities and Stockholders' Equity	\$ 597,399	\$ 623,629

See accompanying notes to unaudited condensed consolidated financial statements.



CORNERSTONE ONDEMAND, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(in thousands, except per share data)  
(unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Revenue	\$ 116,651	\$ 107,013	\$ 228,233	\$ 206,337
Cost of revenue	35,321	35,955	69,270	67,605
Gross profit	81,330	71,058	158,963	138,732
Operating expenses:				
Sales and marketing	62,073	57,835	118,967	114,536
Research and development	14,684	11,782	28,095	22,797
General and administrative	23,141	16,538	43,617	33,003
Amortization of certain acquired intangible assets	—	—	—	150
Total operating expenses	99,898	86,155	190,679	170,486
Loss from operations	(18,568 )	(15,097 )	(31,716 )	(31,754 )
Other income (expense):				
Interest income	659	385	1,272	731
Interest expense	(3,340 )	(3,217 )	(6,642 )	(6,407 )
Other, net	348	482	545	2,275
Other income (expense), net	(2,333 )	(2,350 )	(4,825 )	(3,401 )
Loss before income tax provision	(20,901 )	(17,447 )	(36,541 )	(35,155 )
Income tax provision	(364 )	(141 )	(935 )	(676 )
Net loss	\$(21,265 )	\$(17,588 )	\$(37,476 )	\$(35,831 )
Net loss per share, basic and diluted	\$(0.37 )	\$(0.32 )	\$(0.66 )	\$(0.65 )
Weighted average common shares outstanding, basic and diluted	56,935	55,278	56,789	55,053

See accompanying notes to unaudited condensed consolidated financial statements.

CORNERSTONE ONDEMAND, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(in thousands)

(unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Net loss	\$(21,265)	\$(17,588)	\$(37,476)	\$(35,831)
Other comprehensive (loss) income, net of tax:				
Foreign currency translation adjustment	(1,876 )	1,113	(2,050 )	1,623
Net change in unrealized (losses) gains on investments	19	128	(68 )	467
Other comprehensive (loss) income, net of tax	(1,857 )	1,241	(2,118 )	2,090
Total comprehensive loss	\$(23,122)	\$(16,347)	\$(39,594)	\$(33,741)

See accompanying notes to unaudited condensed consolidated financial statements.

CORNERSTONE ONDEMAND, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(in thousands)  
(unaudited)

	Six Months Ended June 30, 2017	2016
Cash flows from operating activities:		
Net loss	\$ (37,476 )	\$ (35,831 )
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	17,978	15,451
Accretion of debt discount and amortization of debt issuance costs	4,736	4,509
Purchased investment premium, net of amortization	407	562
Net foreign currency gain	(1,145 )	(1,210 )
Stock-based compensation expense	33,447	26,004
Changes in operating assets and liabilities:		
Accounts receivable	19,371	(1,178 )
Deferred commissions	2,009	1,724
Prepaid expenses and other assets	(4,220 )	(2,549 )
Accounts payable	(10,687 )	(2,680 )
Accrued expenses	(7,430 )	(5,888 )
Deferred revenue	(24,033 )	(9,323 )
Other liabilities	1,432	(705 )
Net cash used in operating activities	(5,611 )	(11,114 )
Cash flows from investing activities:		
Purchases of investments	(86,481 )	(61,514 )
Maturities of investments	123,322	77,195
Capital expenditures	(3,740 )	(3,361 )
Capitalized software costs	(11,362 )	(8,227 )
	21,739	4,093



Net cash provided by investing activities			
Cash flows from financing activities:			
Principal payments under capital lease obligations	—	(33	)
Proceeds from employee stock plans	6,311	12,476	
Net cash provided by financing activities	6,311	12,443	
Effect of exchange rate changes on cash and cash equivalents	1,263	(538	)
Net increase in cash and cash equivalents	23,702	4,884	
Cash and cash equivalents at beginning of period	83,300	107,691	
Cash and cash equivalents at end of period	\$ 107,002	\$ 112,575	
Supplemental cash flow information:			
Cash paid for interest	\$ 1,898	\$ 1,898	
Cash paid for income taxes	988	1,096	
Proceeds from employee stock plans received in advance of stock issuance	508	202	
Non-cash investing and financing activities:			
Assets acquired under capital leases and other financing arrangements	\$ 1,824	\$ —	
Capitalized assets financed by accounts payable and accrued expenses	2,631	902	
Capitalized stock-based compensation	2,471	1,885	

See accompanying notes to unaudited condensed consolidated financial statements.

CORNERSTONE ONDEMAND, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Company Overview

Cornerstone OnDemand, Inc. (“Cornerstone” or the “Company”) was incorporated on May 24, 1999 in the state of Delaware and began its principal operations in November 1999.

The Company is a leading global provider of learning and human capital management software, delivered as Software-as-a-Service (“SaaS”). The Company helps organizations around the globe recruit, train and manage their employees. It is one of the world’s largest cloud computing companies. The Company’s human capital management platform combines the world’s leading unified talent management solutions with state-of-the-art analytics and HR administration solutions to enable organizations to manage the entire employee lifecycle. Its focus on continuous learning and development helps organizations to empower employees to realize their potential and drive success. The Company works with clients across all geographies, verticals and market segments. Its Recruiting, Learning, Performance and HR Administration suites help with sourcing, recruiting, and onboarding new hires; managing training and development requirements; nurturing knowledge sharing and collaboration among employees; goal setting reviews, competency management and continuous feedback; linking compensation to performance; identifying development plans based on performance gaps; streamlining employee data management, self-service and compliance reporting; and then utilizing state-of-the-art analytics capabilities to make smarter, more-informed decisions using data from across the platform for talent mobility, engagement and development so that HR and leadership can focus on strategic initiatives to help their organization succeed.

The Company’s management has determined that the Company operates in one segment as it only reports financial information on an aggregate and consolidated basis to the Company’s chief executive officer, who is the Company’s chief operating decision maker.

Office Locations

The Company is headquartered in Santa Monica, California and has offices in Amsterdam, Netherlands; Auckland, New Zealand; Bangalore, India; Düsseldorf, Germany; Hong Kong; London, United Kingdom; Madrid, Spain; Mumbai, India; Munich, Germany; New Delhi, India; Paris, France; São Paulo, Brazil; Shanghai, China; Stockholm, Sweden; Sunnyvale, United States; Sydney, Australia; Tel Aviv, Israel; and Tokyo, Japan.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with (i) United States generally accepted accounting principles (“GAAP”) for interim financial information and (ii) the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, such financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, the financial statements include all adjustments (consisting of normal recurring adjustments) necessary for the fair presentation of the interim periods presented. Results for the three and six months ended June 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017, for any other interim period or for any other future year.

The condensed consolidated balance sheet at December 31, 2016 has been derived from the audited financial statements at that date, but does not include all of the disclosures required by GAAP.

The Company’s significant accounting policies are described in “Note 2. Summary of Significant Accounting Policies” in the Company’s Annual Report on Form 10-K for the year ended December 31, 2016. The Company follows the same accounting policies for interim reporting. The financial information included in this Quarterly Report on Form 10-Q should be read in conjunction with the Company’s consolidated financial statements and related notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2016.

#### Use of Estimates

Beginning in 2017, the Company updated one of the assumptions used in the Black-Scholes option pricing model by utilizing the expected volatility based on its historical volatility as a public company. In previous years, the Company estimated this using the average volatility of the Company and similar publicly traded companies as sufficient trading history of the Company's stock was not available.

#### Recently Adopted Accounting Pronouncements

In January 2017, the Financial Accounting Standards Board ("FASB") issued a new accounting standards update ("ASU") which amends the reporting requirement in regard to new accounting pronouncements or existing pronouncements that have not yet been adopted. The guidance requires registrants to disclose the effect that recently issued accounting standards will have on their financial statements when adopted in a future period. The Company implemented this requirement as of the beginning of the first quarter of 2017.

In March 2016, the FASB issued a new ASU to simplify several areas of accounting for share-based compensation arrangements, including the income tax impact, classification on the statement of cash flows and forfeitures. The Company adopted this ASU as of the beginning of the first quarter of 2017 and has elected to continue to estimate expected forfeitures over the course of a vesting period. Further, the ASU eliminates the requirement to delay the recognition of excess tax benefits until they reduce current taxes payable. However, as of January 1, 2017, the previously unrecognized excess tax benefits of \$39.4 million had no impact on our accumulated deficit balance as the related U.S. deferred tax assets were fully offset by a valuation allowance. The adoption did not have any other material impacts on the Company's financial statements.

#### Recent Accounting Pronouncements

In May 2017, the FASB issued a new ASU which amends the scope of modification accounting for share-based payment arrangements. It provides guidance on the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting under ASC 718. This guidance is effective for the Company's interim and annual reporting periods beginning January 1, 2018. The Company does not expect the adoption of this ASU to have a material impact on its financial statements.

In August 2016, the FASB issued a new ASU to clarify how companies present and classify certain cash receipts and cash payments in the statement of cash flows. This guidance is effective for our interim and annual reporting period beginning January 1, 2018. The Company does not expect the adoption of this ASU to have a material impact on its financial statements.

In February 2016, the FASB issued a new ASU, which amends a number of aspects of lease accounting, including requiring lessees to recognize operating leases with a term greater than one year on their balance sheet as a right-of-use asset and corresponding lease liability, measured at the present value of the lease payments. This guidance is effective for the Company's interim and annual reporting periods beginning January 1, 2019. Upon adoption, the Company expects additional lease liability to be recognized on the consolidated balance sheets. The Company is currently evaluating the impact of the adoption of this ASU on its financial statements.

In January 2016, the FASB issued a new ASU that provides guidance for the recognition, measurement, presentation, and disclosure of financial assets and liabilities. This guidance is effective for the Company's interim and annual reporting periods beginning January 1, 2018. The Company does not expect the adoption of this ASU to have a material impact on its financial statements.

In May 2014, the FASB issued a new ASU that provides guidance for a model for recognizing revenue from contracts with customers. Under the new standard, the Company is required to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the expected consideration entitled in exchange for those goods or services. The standard permits the use of the full retrospective method, in which case the standard would be applied to each prior reporting period presented and the cumulative effect of applying the standard would be recognized at the earliest period shown, or the modified retrospective method, in which case the cumulative effect of applying the standard would be recognized at the date of initial application. The Company has evaluated the transition methods and elected to use the modified retrospective method and will adopt this standard beginning January 1, 2018. The Company anticipates that this standard will have a material impact on its consolidated financial statements but is still evaluating the accounting, transition and disclosure requirements of the standard. The Company estimates that the

most significant impact will result from how it recognizes revenue for professional services, which will be based on the relative selling price without limitation to its contractual value. This change is expected to result in an increase in the aggregate amount allocated to professional services when allocating total contract values using the relative selling price method under the new standard. Additionally, the Company expects to recognize a portion of commission expense associated with new business over the expected customer life as opposed to over the term of the arrangement.

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## 2. NET LOSS PER SHARE

The following table presents the Company's basic and diluted net loss per share (in thousands, except per share amounts):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Net loss	\$(21,265)	\$(17,588)	\$(37,476)	\$(35,831)
Weighted-average shares of common stock outstanding	56,935	55,278	56,789	55,053
Net loss per share – basic and diluted	\$(0.37 )	\$(0.32 )	\$(0.66 )	\$(0.65 )

At June 30, 2017 and 2016, the following shares were excluded from the computation of diluted net loss per share because the effect of these shares would have been anti-dilutive (in thousands):

	June 30,	
	2017	2016
Options to purchase common stock, restricted stock units and performance-based restricted stock units	11,274	10,147
Shares issuable pursuant to employee stock purchase plan	101	85
Convertible notes	4,682	4,682
Common stock warrants	4,682	4,682
Total shares excluded from net loss per share	20,739	19,596

Under the treasury stock method, the convertible notes and common stock warrants will have a dilutive impact on net earnings per share when the average stock price for the period exceeds the respective conversion prices and the Company has net income. The Company also entered into note hedge transactions ("Note Hedges") in connection with the convertible notes with respect to its common stock to minimize the impact of potential economic dilution upon conversion of the convertible notes. The Note Hedges were outstanding as of June 30, 2017. Since the beneficial impact of the Note Hedges is anti-dilutive, they are excluded from the calculation of diluted net income (loss) per share. See Note 6 of the Notes to Condensed Consolidated Financial Statements.

## 3. INVESTMENTS

### Investments in Marketable Securities

The Company's investments in available-for-sale marketable securities are made pursuant to its investment policy, which has established guidelines relative to the diversification of the Company's investments and their maturities, with the principal objective of capital preservation and maintaining liquidity that is sufficient to meet cash flow requirements.

The following is a summary of investments in marketable securities, including those that meet the definition of a cash equivalent, as of June 30, 2017 (in thousands):

	June 30, 2017				Cash and Cash Equivalent	Investments
	Amortized Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value		
Money market funds	\$62,709	\$ —	\$ —	\$62,709	\$ 62,709	\$ —
Corporate bonds	57,292	3	(33 )	57,262	—	57,262
Agency bonds	8,015	—	(22 )	7,993	—	7,993
U.S. treasury securities	153,010	1	(233 )	152,778	13,998	138,780
Commercial paper	15,967	—	—	15,967	—	15,967
	\$296,993	\$ 4	\$ (288 )	\$296,709	\$ 76,707	\$ 220,002

The following is a summary of investments in marketable securities, including those that meet the definition of a cash equivalent, as of December 31, 2016 (in thousands):

	December 31, 2016					
	Amortized Cost Basis	Unrealized Gains	Unrealized Losses	Fair Value	Cash and Cash Equivalent	Investments
Money market funds	\$48,136	\$ —	\$ —	\$48,136	\$ 48,136	\$ —
Corporate bonds	60,725	1	(50 )	60,676	—	60,676
Agency bonds	28,954	2	(26 )	28,930	—	28,930
U.S. treasury securities	157,829	17	(160 )	157,686	—	157,686
Commercial paper	10,473	—	—	10,473	—	10,473
	\$306,117	\$ 20	\$ (236 )	\$305,901	\$ 48,136	\$ 257,765

As of June 30, 2017, the Company's investment in corporate bonds, agency bonds, U.S. treasury securities and commercial paper had a weighted-average maturity date of approximately five months. Unrealized gains and losses on investments were not significant, and the Company does not believe the unrealized losses represent other-than-temporary impairments as of June 30, 2017 and December 31, 2016. No marketable securities held have been in a continuous unrealized loss position for more than 12 months as of June 30, 2017 and December 31, 2016.

#### Strategic Investments

As of June 30, 2017, the Company had aggregate strategic investments of \$2.0 million. The Company accounted for each of these investments using the cost method of accounting, as the Company does not have significant influence or a controlling financial interest over these entities. During the three months ended June 30, 2017, the Company did not make any strategic investments. During the six months ended June 30, 2017, the Company made \$0.5 million in strategic investments.

These investments are subject to periodic impairment reviews and are considered to be impaired when a decline in fair value is judged to be other-than-temporary. During the three months ended June 30, 2017, the Company did not recognize any impairment losses. During the six months ended June 30, 2017, the Company recognized \$0.6 million of impairment losses.

#### 4. INTANGIBLE ASSETS

The Company has finite-lived intangible assets which are amortized over their estimated useful lives on a straight-line basis. The following table presents the gross carrying amount and accumulated amortization of finite-lived intangible assets as of June 30, 2017 and December 31, 2016 (in thousands):

	June 30, 2017			December 31, 2016		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	\$29,984	\$ (27,075 )	\$ 2,909	\$29,984	\$ (22,711 )	\$ 7,273
Software license rights	1,654	(1,577 )	77	1,654	(1,506 )	148
Total	\$31,638	\$ (28,652 )	\$ 2,986	\$31,638	\$ (24,217 )	\$ 7,421

Total amortization expense from finite-lived intangible assets was \$2.2 million and \$4.4 million for the three and six months ended June 30, 2017, respectively, and \$2.2 million and \$4.8 million for the three and six months ended June 30, 2016, respectively. Amortization expense of \$2.2 million and \$4.4 million for the three and six months ended June 30, 2017, respectively, and \$2.2 million and \$4.7 million for the three and six months ended June 30, 2016, respectively, related to developed technology and software license rights, was recorded in cost of revenue and the remainder was recorded in "Amortization of certain acquired intangible assets" in the accompanying Condensed Consolidated Statements of Operations.

The following table presents the Company's estimate of remaining amortization expense, which will be recorded in cost of revenue, for each of the succeeding fiscal years ending December 31 for finite-lived intangible assets that existed at June 30, 2017 (in thousands):

Remainder of 2017	\$2,986
Total	\$2,986

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The Company evaluates the recoverability of its long-lived assets with finite useful lives, including intangible assets, for impairment whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable. Based on the assessment of various factors in connection with the preparation of the Company's financial statements for the quarter ended June 30, 2017, the Company does not believe there were any negative qualitative factors impacting the recoverability of the carrying values. There were no impairment charges related to identifiable intangible assets in the six months ended June 30, 2017 and the year ended December 31, 2016.

## 5. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value represents the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. Observable inputs are based on market data obtained from independent sources. The fair value hierarchy is based on the following three levels of inputs, of which the first two are considered observable and the last one is considered unobservable:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.

Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 – Unobservable inputs.

Assets and liabilities measured at fair value on a recurring basis included the following as of June 30, 2017 and December 31, 2016 (in thousands):

	June 30, 2017				December 31, 2016			
	Fair Value	Level 1	Level 2	Level 3	Fair Value	Level 1	Level 2	Level 3
Cash equivalents	\$76,707	\$62,709	\$13,998	\$ —	\$48,136	\$48,136	\$ —	\$ —
Corporate bonds	57,262	—	57,262	—	60,676	—	60,676	—
Agency bonds	7,993	—	7,993	—	28,930	—	28,930	—
U.S. treasury securities	138,780	—	138,780	—	157,686	—	157,686	—
Commercial paper	15,967	—	15,967	—	10,473	—	10,473	—
	\$296,709	\$62,709	\$234,000	\$ —	\$305,901	\$48,136	\$257,765	\$ —

At June 30, 2017 and December 31, 2016, cash equivalents of \$62.7 million and \$48.1 million, respectively, consisted of money market funds with original maturity dates of three months or less backed by U.S. Treasury bills. At June 30, 2017, cash equivalents of \$14.0 million consisted of U.S. treasury securities with original maturity dates of three months or less.

As of June 30, 2017, corporate bonds, agency bonds, U.S. treasury securities and commercial paper were classified within Level 2 of the fair value hierarchy. The bonds were valued using information obtained from pricing services, which obtained quoted market prices from a variety of industry data providers, security master files from large financial institutions, and other third-party sources. The Company performed supplemental analysis to validate information obtained from its pricing services. As of June 30, 2017, no adjustments were made to such pricing information.

### Senior Convertible Notes

The Company's senior convertible notes are shown in the accompanying Condensed Consolidated Balance Sheets at their original issuance value, net of unamortized discount and debt issuance costs, and are not re-measured to fair value each period. The approximate fair value of the Company's convertible notes as of June 30, 2017 was \$254.6 million. The fair value of the convertible notes was estimated on the basis of quoted market prices, which, due to limited trading activity, are considered Level 2 in the fair value hierarchy.

## 6. DEBT

### Senior Convertible Notes

In 2013, the Company issued senior convertible notes (the "Notes") raising gross proceeds of \$253.0 million.



The Notes are governed by an Indenture, dated June 17, 2013 (the “Indenture”), between the Company and U.S. Bank National Association, as trustee. The Notes mature on July 1, 2018, unless earlier repurchased or converted, and bear interest at a rate of 1.50% per year payable semi-annually in arrears on January 1 and July 1 of each year, commencing January 1, 2014.

The Notes are convertible at an initial conversion rate of 18.5046 shares of the Company's common stock per \$1,000 principal amount of the Notes, which represents an initial conversion price of approximately \$54.04 per share, subject to adjustment for anti-dilutive issuances, voluntary increases in the conversion rate and make-whole adjustments upon a fundamental change. A fundamental change includes a change in control, delisting of the Company's common stock and a liquidation of the Company. Upon conversion, the Company will deliver cash for the principal amount, and the Company has the right to settle any amounts in excess of the principal in cash or shares. Prior to April 1, 2018, the Notes are only convertible upon satisfaction of certain conditions as follows:

- during any calendar quarter after September 30, 2013, if the last reported sale price of common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price on each applicable trading day;
- during the five business day period after any five consecutive trading day period in which the trading price per \$1,000 principal amount of the Notes for each trading day of that five consecutive trading day period was less than 98% of the product of the last reported sale price of common stock and the conversion rate on each such trading day; or
- upon the occurrence of specified corporate events as defined in the Indenture.

Holders of the Notes may convert their Notes at any time on or after April 1, 2018, until the close of business on the second scheduled trading day immediately preceding the maturity date.

The holders of the Notes may require the Company to repurchase all or a portion of their Notes at a cash repurchase price equal to 100% of the principal amount of the Notes being repurchased, plus accrued and unpaid interest, upon a fundamental change and events of default, including non-payment of interest or principal and other obligations under the Indenture.

In accounting for the Notes at issuance, the Company separated the Notes into debt and equity components pursuant to the accounting standards for convertible debt instruments that may be fully or partially settled in cash upon conversion. The fair value of the debt component was estimated using an interest rate for nonconvertible debt, with terms similar to the Notes, excluding the conversion feature. The carrying amount of the liability component was calculated by measuring the fair value of a similar liability that does not have an associated convertible feature. The excess of the principal amount of the Notes over the fair value of the debt component was recorded as a debt discount and a corresponding increase in additional paid-in capital. The debt discount is accreted to interest expense over the term of the Notes using the interest method. The amount recorded to additional paid-in capital is not to be remeasured as long as it continues to meet the conditions for equity classification. Upon issuance of the \$253.0 million of Notes, the Company recorded \$214.3 million to debt and \$38.7 million to additional paid-in capital for the debt discount. The Company incurred transaction costs of approximately \$7.3 million related to the issuance of the Notes. In accounting for these costs, the Company allocated the costs to the debt and equity components in proportion to the allocation of proceeds from the issuance of the Notes to such components. Transaction costs allocated to the debt component of \$6.2 million are deferred and amortized to interest expense over the term of the Notes. The transaction costs allocated to the equity component of \$1.1 million were recorded to additional paid-in capital.

The net carrying amount of the liability component of the Notes as of June 30, 2017 and December 31, 2016 consists of the following (in thousands):

	June 30, 2017	December 31, 2016
Principal amount	\$253,000	\$ 253,000
Unamortized debt discount	(8,470 )	(12,550 )
Net carrying amount before unamortized debt issuance costs	244,530	240,450
Unamortized debt issuance costs	(1,359 )	(2,015 )
Net carrying value	\$243,171	\$ 238,435



The effective interest rate of the liability component of the Notes is 5.4%. This interest rate was based on the interest rates of similar liabilities at the time of issuance that did not have associated convertible features.

The following table presents the interest expense recognized related to the Notes for the three and six months ended June 30, 2017 and 2016 (in thousands):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Contractual interest expense at 1.5% per annum	\$949	\$949	\$1,898	\$1,898
Amortization of debt issuance costs	330	314	656	624
Accretion of debt discount	2,053	1,954	4,081	3,885
Total	\$3,332	\$3,217	\$6,635	\$6,407

The net proceeds from the Notes were approximately \$246.0 million after payment of the initial purchasers' offering expenses. The Company used approximately \$49.5 million of the net proceeds of the Notes offering to pay the cost of the Note Hedges described below, which was partially offset by \$23.2 million of the proceeds from the Company's sale of the Warrants also described below.

#### Note Hedges

Concurrent with the issuance of the Notes, the Company entered into note hedges (the "Note Hedges") with certain bank counterparties, with respect to its common stock. The Company paid \$49.5 million for the Note Hedges. The Note Hedges cover approximately 4.7 million shares of the Company's common stock at a strike price of \$54.04 per share, and are exercisable by the Company upon conversion of the Notes. The Note Hedges will expire upon the maturity of the Notes. The Note Hedges are intended to reduce the potential economic dilution upon conversion of the Notes in the event that the fair value per share of the Company's common stock at the time of exercise is greater than the conversion price of the Notes.

#### Warrants

Separately and concurrently with the entry by the Company into the Note Hedges, the Company entered into warrant transactions, whereby it sold warrants to the same bank counterparties as the Note Hedges to acquire up to 4.7 million shares of the Company's common stock at a strike price of \$80.06 per share (the "Warrants"), subject to anti-dilution adjustments. The Company received proceeds of \$23.2 million from the sale of the Warrants. The Warrants expire at various dates during 2018 and 2019. If the fair value per share of the Company's common stock exceeds the strike price of the Warrants, the Warrants will reduce diluted earnings per share to the extent that the calculation does not have an anti-dilutive effect.

The amounts paid and received for the Note Hedges and the Warrants have been recorded in additional paid-in capital. The fair value of the Note Hedges and the Warrants are not remeasured through earnings each reporting period.

## 7. STOCK-BASED AWARDS

#### Stock Options

The following table summarizes the Company's stock option activity for the six months ended June 30, 2017 (in thousands, except per share and term information):

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value (1)
Outstanding, December 31, 2016	6,041	\$ 32.01	6.2	\$ 74,989
Granted	—	—		
Exercised	(146 )	23.49		
Forfeited	(118 )	46.44		
Outstanding, June 30, 2017	5,777	\$ 31.93	5.7	\$ 49,795



	Shares	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term	Aggregate Intrinsic Value (1)
Exercisable at June 30, 2017	5,127	\$ 30.86	5.5	\$ 49,380
Vested and expected to vest at June 30, 2017	5,752	31.90	5.7	49,776

(1)Based on the Company's closing stock price of \$35.75 on June 30, 2017 and \$42.31 on December 31, 2016.

Unrecognized compensation expense relating to stock options was \$10.7 million at June 30, 2017, which is expected to be recognized over a weighted-average period of 1.3 years.

#### Restricted Stock Units

The Company granted restricted stock units covering 1.0 million shares of its common stock during the six months ended June 30, 2017. At June 30, 2017, there were 3.7 million shares of the Company's common stock issuable upon the vesting of outstanding restricted stock units. Unrecognized compensation expense related to shares of the Company's common stock subject to unvested restricted stock units was \$104.5 million at June 30, 2017, which is expected to be recognized as expense over the weighted-average period of 2.9 years.

#### Performance-Based Restricted Stock Units

In July 2014, the Compensation Committee of the Company's Board of Directors (the "Compensation Committee") approved the issuance of performance-based restricted stock units to an executive officer of the Company. The number of shares of the Company's common stock issuable upon the vesting of this performance-based restricted stock award is based upon (a) the performance of the Company's stock price relative to a certain independent market index and (b) the recipient continuing to provide service through the end of the three year term of the award. Achievement of the target performance level would result in the issuance of 40,600 shares and achievement at the maximum performance level would result in the issuance of 60,900 shares. The Company used a Monte Carlo simulation to estimate the fair value of this award which factors in the probability of the award vesting. The grant date fair value of the award was \$1.8 million, which was recognized ratably over the three year term of the award.

In December 2014, the Compensation Committee approved the issuance of a special award of performance-based restricted stock units to certain executives of the Company. The number of shares of the Company's common stock issuable upon the vesting of these performance-based restricted stock unit awards is based upon (a) the performance of the Company's stock price relative to a certain independent market index, (b) the achievement of the Company's revenue guidance for each of fiscal year 2015 and 2016 and (c) the recipient continuing to provide services to the Company through the end of the three year term of the award. The Company finalizes its revenue guidance in February of each year, thus a grant date was established in February of 2015 and February of 2016 for each of the two tranches of the award related to that year's revenue guidance. Each tranche is treated as a separate grant and recognized from the date the revenue guidance is determined over the remaining portion of the original three year term of the award. Achievement of the target performance level would result in the issuance of 535,000 shares and achievement at the maximum performance level would result in the issuance of an aggregate of 1,070,000 shares.

The Company used a Monte Carlo simulation to estimate the fair value of each tranche of the awards for which a grant date has been established. The valuation factors in the probability of achieving the performance of the Company's stock price relative to the market index. In the first quarter of 2015, the aggregate grant date fair value of the first half of the above awards was \$9.9 million. As of June 30, 2017, the aggregate fair value of the first half of the awards was \$4.8 million based on the Company's performance in relation to the revenue guidance for fiscal year 2015. In the first quarter of 2016, the aggregate grant date fair value of the second half of the awards was \$3.6 million. In the first quarter of 2017, the Compensation Committee provided clarification on the use of constant currency adjustments to the Company's performance in relation to the revenue guidance for fiscal year 2016. As a result, during the six months ended June 30, 2017, the Company determined that the aggregate fair value of the awards was \$9.8 million, which will be recognized over the remaining vesting period of the awards.



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The following table summarizes the details of the first half of the performance-based restricted stock units granted in December 2014 (in thousands, except share information):

Date	Activity	# of shares at Target	# of shares at Maximum
February 2015	Accounting grant date	267,500	535,000
December 2015	Adjustment for the measurement of the Company's performance in relation to the revenue guidance for fiscal year 2015	(133,750)	(267,500 )
May 2016	Adjustment for shares forfeited as a result of the retirement of an executive officer of the Company	(5,000 )	(10,000 )
	Eligible for potential issuance at June 30, 2017	128,750	257,500

The following table summarizes the details of the second half of the performance-based restricted stock units granted in December 2014 (in thousands, except share information):

Date Activity