# Appendix

## APPENDIX - RECONCILIATION OF NON-GAAP FINANCIAL MEASURES

**Non-GAAP Results**
(In thousands)
The following table shows Zendesk's GAAP results reconciled to non-GAAP results.

| | Year ended December 31, 2018 | Year ended December 31, 2017 | Year ended December 31, 2016 | Year ended December 31, 2015 | Year ended December 31, 2014 |
|---|---|---|---|---|---|
| **Reconciliation of gross profit and gross margin** | | | | | |
| GAAP gross profit | $ 417,491 | $ 302,743 | $ 218,944 | $ 141,584 | $ 81,002 |
| Plus: Share-based compensation | 14,835 | 9,040 | 7,045 | 4,541 | 2,464 |
| Plus: Employer tax related to employee stock transactions | 1,036 | 530 | 383 | 175 | 29 |
| Plus: Amortization of purchased intangibles | 3,789 | 3,209 | 3,362 | 1,890 | 1,167 |
| Plus: Amortization of share-based compensation capitalized in | 1,487 | 1,774 | 1,821 | 1,065 | 402 |
| Plus: Acquisition-related expenses | 152 | — | — | — | — |
| Non-GAAP gross profit | $ 438,790 | $ 317,296 | $ 231,555 | $ 149,255 | $ 85,064 |
| GAAP gross margin | 70% | 70% | 70% | 68% | 64% |
| Non-GAAP adjustments | 3% | 4% | 4% | 3% | 3% |
| Non-GAAP gross margin | 73% | 74% | 74% | 71% | 67% |
| **Reconciliation of operating expenses** | | | | | |
| GAAP research and development | $ 160,260 | $ 115,291 | $ 91,067 | $ 62,615 | $ 36,403 |
| Less: Share-based compensation | (41,365) | (29,970) | (27,083) | (19,414) | (10,918) |
| Less: Employer tax related to employee stock transactions | (3,884) | (1,971) | (1,559) | (415) | (129) |
| Less: Acquisition-related expenses | (2,335) | (843) | — | — | — |
| Non-GAAP research and development | $ 112,676 | $ 82,507 | $ 62,425 | $ 42,786 | $ 25,356 |
| GAAP research and development as percentage of revenue | 27% | 27% | 29% | 30% | 29% |
| Non-GAAP research and development as percentage of revenue | 19% | 19% | 20% | 20% | 20% |
| GAAP sales and marketing | $ 291,668 | $ 211,918 | $ 161,653 | $ 114,052 | $ 77,875 |
| Less: Share-based compensation | (37,882) | (24,279) | (22,693) | (14,759) | (10,680) |
| Less: Employer tax related to employee stock transactions | (2,158) | (1,164) | (1,342) | (474) | (314) |
| Less: Amortization of purchased intangibles | (975) | (495) | (418) | (346) | (303) |
| Less: Acquisition-related expenses | (1,259) | (750) | — | — | — |
| Non-GAAP sales and marketing | $ 249,394 | $ 185,230 | $ 137,200 | $ 98,473 | $ 66,578 |
| GAAP sales and marketing as percentage of revenue | 49% | 49% | 52% | 55% | 61% |
| Non-GAAP sales and marketing as percentage of revenue | 42% | 43% | 44% | 47% | 52% |
| GAAP general and administrative | $ 103,491 | $ 81,680 | $ 64,371 | $ 47,902 | $ 32,869 |
| Less: Share-based compensation | (25,401) | (21,263) | (16,608) | (13,842) | (8,077) |
| Less: Employer tax related to employee stock transactions | (1,837) | (1,184) | (586) | (387) | (113) |
| Less: Acquisition-related expenses | (3,073) | (566) | — | (998) | (649) |
| Non-GAAP general and administrative | $ 73,180 | $ 58,667 | $ 47,177 | $ 32,675 | $ 24,030 |
| GAAP general and administrative as percentage of revenue | 17% | 19% | 21% | 23% | 26% |
| Non-GAAP general and administrative as percentage of revenue | 12% | 14% | 15% | 16% | 19% |
| **Reconciliation of operating loss and operating margin** | | | | | |
| GAAP operating loss | $ (137,928) | $ (106,146) | $ (98,147) | $ (82,985) | $ (66,145) |
| Plus: Share-based compensation | 119,483 | 84,552 | 73,429 | 52,556 | 32,139 |
| Plus: Employer tax related to employee stock transactions | 8,915 | 4,849 | 3,870 | 1,451 | 585 |
| Plus: Amortization of purchased intangibles | 4,764 | 3,704 | 3,780 | 2,236 | 1,470 |
| Plus: Acquisition-related expenses | 6,819 | 2,159 | — | 998 | 649 |
| Plus: Amortization of share-based compensation capitalized in | 1,487 | 1,774 | 1,821 | 1,065 | 402 |
| Non-GAAP operating income (loss) | $ 3,540 | $ (9,108) | $ (15,247) | $ (24,679) | $ (30,900) |
| GAAP operating margin | (23%) | (25%) | (31%) | (40%) | (52%) |
| Non-GAAP adjustments | 24% | 23% | 26% | 28% | 28% |
| Non-GAAP operating margin | 1% | (2%) | (5%) | (12%) | (24%) |
| **Computation of free cash flow** | | | | | |
| Net cash provided by operating activities | $ 78,620 | $ 42,228 | $ 24,560 | $ 5,333 | $ 2,090 |
| Less: purchases of property and equipment | (35,323) | (16,396) | (20,647) | (22,989) | (21,665) |
| Less: internal-use software development costs | (7,005) | (7,521) | (6,310) | (4,705) | (8,013) |
| Free cash flow | $ 36,292 | $ 18,311 | $ (2,397) | $ (22,361) | $ (27,588) |

2014-2015 reflect ASC 605. 2016-2018 reflect ASC 606.

# Appendix - About Non-GAAP Financial Measures

To provide investors and others with additional information regarding Zendesk's results, the following non-GAAP financial measures were disclosed: non-GAAP gross profit and gross margin, non-GAAP operating expenses, non-GAAP operating income (loss) and operating margin, non-GAAP net income (loss), non-GAAP net income (loss) per share, basic and diluted, free cash flow, and free cash flow margin.

Specifically, Zendesk excludes the following from its historical and prospective non-GAAP financial measures, as applicable:

Share-based Compensation and Amortization of Share-based Compensation Capitalized in Internal-use Software: Zendesk utilizes share-based compensation to attract and retain employees. It is principally aimed at aligning their interests with those of its stockholders and at long-term retention, rather than to address operational performance for any particular period. As a result, share-based compensation expenses vary for reasons that are generally unrelated to financial and operational performance in any particular period.

Employer Tax Related to Employee Stock Transactions: Zendesk views the amount of employer taxes related to its employee stock transactions as an expense that is dependent on its stock price, employee exercise and other award disposition activity, and other factors that are beyond Zendesk's control. As a result, employer taxes related to its employee stock transactions vary for reasons that are generally unrelated to financial and operational performance in any particular period.

Amortization of Purchased Intangibles: Zendesk views amortization of purchased intangible assets, including the amortization of the cost associated with an acquired entity's developed technology, as items arising from pre-acquisition activities determined at the time of an acquisition. While these intangible assets are evaluated for impairment regularly, amortization of the cost of purchased intangibles is an expense that is not typically affected by operations during any particular period.

Acquisition-Related Expenses: Zendesk views acquisition-related expenses, such as transaction costs, integration costs, restructuring costs, and acquisition-related retention payments, including amortization of acquisition-related retention payments capitalized in internal-use software, as events that are not necessarily reflective of operational performance during a period. In particular, Zendesk believes the consideration of measures that exclude such expenses can assist in the comparison of operational performance in different periods which may or may not include such expenses.

Amortization of Debt Discount and Issuance Costs: In March 2018, Zendesk issued $575 million of convertible senior notes due in 2023, which bear interest at an annual fixed rate of 0.25%. The imputed interest rate of the convertible senior notes was approximately 5.26%. This is a result of the debt discount recorded for the conversion feature that is required to be separately accounted for as equity, and debt issuance costs, which reduce the carrying value of the convertible debt instrument. The debt discount is amortized as interest expense together with the issuance costs of the debt. The expense for the amortization of debt discount and debt issuance costs is a non-cash item, and we believe the exclusion of this interest expense will provide for a more useful comparison of our operational performance in different periods.

Income Tax Effects: Zendesk utilizes a fixed long-term projected tax rate in its computation of non-GAAP income tax effects to provide better consistency across interim reporting periods. In projecting this long-term non-GAAP tax rate, Zendesk utilizes a financial projection that excludes the direct impact of other non-GAAP adjustments. The projected rate considers other factors such as Zendesk's current operating structure, existing tax positions in various jurisdictions, and key legislation in major jurisdictions where Zendesk operates. For the year ended December 31, 2019, Zendesk has determined the projected non-GAAP tax rate to be 21%. Zendesk will periodically re-evaluate this tax rate, as necessary, for significant events, based on relevant tax law changes, material changes in the forecasted geographic earnings mix, and any significant acquisitions.

Zendesk provides disclosures regarding its free cash flow, which is defined as net cash from operating activities, less purchases of property and equipment and internal-use software development costs. Free cash flow margin is calculated as free cash flow as a percentage of total revenue. Zendesk uses free cash flow, free cash flow margin, and other measures, to evaluate the ability of its operations to generate cash that is available for purposes other than capital expenditures and capitalized software development costs. Zendesk believes that information regarding free cash flow and free cash flow margin provides investors with an important perspective on the cash available to fund ongoing operations.

Zendesk has not reconciled each of free cash flow and free cash flow margin to net cash from operating activities for the year ending December 31, 2019 because Zendesk does not provide guidance on the reconciling items between net cash from operating activities and each of free cash flow and free cash flow margin as a result of the uncertainty regarding, and the potential variability of, these items. The actual amount of such reconciling items will have a significant impact on Zendesk's free cash flow and free cash flow margin and, accordingly, a reconciliation of net cash from operating activities to each of free cash flow and free cash flow margin for the year ending December 31, 2019 is not available without unreasonable effort.

# Appendix - About Non-GAAP Financial Measures

Zendesk does not provide a reconciliation of its non-GAAP operating margin guidance to GAAP operating margin for future periods beyond the current fiscal year because Zendesk does not provide guidance on the reconciling items between GAAP operating margin and non-GAAP operating margin for such periods, as a result of the uncertainty regarding, and the potential variability of, these items. The actual amount of such reconciling items will have a significant impact on Zendesk's non-GAAP operating margin and, accordingly, a reconciliation of GAAP operating margin to non-GAAP operating margin guidance for such periods is not available without unreasonable effort. Zendesk's disclosures regarding its expectations for its non-GAAP gross margin include adjustments to its expectations for its GAAP gross margin that exclude share-based compensation and related expenses in Zendesk's cost of revenue, amortization of purchased intangibles primarily related to developed technology, and acquisition-related expenses. The share-based compensation and related expenses excluded due to such adjustments are primarily comprised of the share-based compensation and related expenses for employees associated with Zendesk's infrastructure and customer experience organization.

Zendesk does not provide a reconciliation of its non-GAAP gross margin guidance to GAAP gross margin for future periods because Zendesk does not provide guidance on the reconciling items between GAAP gross margin and non-GAAP gross margin, as a result of the uncertainty regarding, and the potential variability of, these items. The actual amount of such reconciling items will have a significant impact on Zendesk's non-GAAP gross margin and, accordingly, a reconciliation of GAAP gross margin to non-GAAP gross margin guidance for the period is not available without unreasonable effort.

Zendesk uses non-GAAP financial information to evaluate its ongoing operations and for internal planning and forecasting purposes. Zendesk's management does not itself, nor does it suggest that investors should, consider such non-GAAP financial measures in isolation from, or as a substitute for, financial information prepared in accordance with GAAP. Zendesk presents such non-GAAP financial measures in reporting its financial results to provide investors with an additional tool to evaluate Zendesk's operating results. Zendesk believes these non-GAAP financial measures are useful because they allow for greater transparency with respect to key metrics used by management in its financial and operational decision-making. This allows investors and others to better understand and evaluate Zendesk's operating results and future prospects in the same manner as management.

Zendesk's management believes it is useful for itself and investors to review, as applicable, both GAAP information that may include items such as share-based compensation and related expenses, amortization of debt discount and issuance costs, amortization of purchased intangibles, and acquisition-related expenses, and the non-GAAP measures that exclude such information in order to assess the performance of Zendesk's business and for planning and forecasting in subsequent periods. When Zendesk uses such a non-GAAP financial measure with respect to historical periods, it provides a reconciliation of the non-GAAP financial measure to the most closely comparable GAAP financial measure. When Zendesk uses such a non-GAAP financial measure in a forward-looking manner for future periods, and a reconciliation is not determinable without unreasonable effort, Zendesk provides the reconciling information that is determinable without unreasonable effort and identifies the information that would need to be added or subtracted from the non-GAAP measure to arrive at the most directly comparable GAAP measure. Investors are encouraged to review the related GAAP financial measures and the reconciliation of these non-GAAP financial measures to their most directly comparable GAAP financial measure as detailed above.