



# GAAP/Non-GAAP Reconciliation and Other Management Metrics

4th Quarter 2015



# Use of Non-GAAP Financial Information

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## USE OF NON-GAAP FINANCIAL INFORMATION

The Company occasionally utilizes financial measures and terms not calculated in accordance with generally accepted accounting principles in the United States (“GAAP”) in order to provide investors with an alternative method for assessing our operating results in a manner that enables investors to more thoroughly evaluate our current performance as compared to past performance. We also believe these Non-GAAP measures provide investors with a more informed baseline for modeling the Company’s future financial performance. Management uses these Non-GAAP financial measures to make operational and investment decisions, to evaluate the Company’s performance, to forecast and to determine compensation. Further, management utilizes these performance measures for purposes of comparison with its business plan and individual operating budgets and allocation of resources. We believe that our investors should have access to, and that we are obligated to provide, the same set of tools that we use in analyzing our results. These Non-GAAP measures should be considered in addition to results prepared in accordance with GAAP, but should not be considered a substitute for or superior to GAAP results. We have provided definitions below for certain Non-GAAP financial measures, together with an explanation of why management uses these measures and why management believes that these Non-GAAP financial measures are useful to investors.

## ADJUSTED NON-GAAP MEASURES

Our Non-GAAP measures adjust GAAP Gross profit, Operating income, Net income, Net income per share - diluted, and EBITDA for non-cash stock-based compensation expense, and strategic consulting and litigation costs, and executive separation payment to derive Non-GAAP adjusted Gross profit, adjusted Operating income, adjusted Net income, adjusted Net income per share - diluted and adjusted EBITDA. We provide a reconciliation of these adjusted Non-GAAP measures to GAAP Gross profit, Operating income, Net income, Net income per share - diluted and EBITDA.

We do not provide a reconciliation of forward-looking adjusted Non-GAAP earnings per share to GAAP earnings per share. Our forward-looking adjusted Non-GAAP earnings per share information consistently excludes non-cash stock-based compensation expense. Additionally, the adjusted Non-GAAP earnings per share will consistently exclude non-recurring items that impact our ongoing business.

# Reconciliation of GAAP to Non-GAAP Financial Measures

Unaudited

	Three Months Ended December 31,		Twelve Months Ended December 31,	
	2015	2014	2015	2014
Revenue:				
GAAP revenue	\$ 14,327,000	\$ 12,865,000	\$ 54,713,000	\$ 50,347,000
Cost of revenue				
GAAP cost of revenue	\$ 2,522,000	\$ 2,205,000	\$ 9,593,000	\$ 8,324,000
Stock-based compensation charges (1)	(A) (45,000)	(34,000)	(181,000)	(180,000)
Non-GAAP adjusted cost of revenue	\$ 2,477,000	\$ 2,171,000	\$ 9,412,000	\$ 8,144,000
Gross profit:				
GAAP gross profit	\$ 11,805,000	\$ 10,660,000	\$ 45,120,000	\$ 42,023,000
Stock-based compensation charges (1)	(A) 45,000	34,000	181,000	180,000
Non-GAAP adjusted gross profit	\$ 11,850,000	\$ 10,694,000	\$ 45,301,000	\$ 42,203,000
Research and development expense				
GAAP research and development expense	\$ 2,074,000	\$ 2,398,000	\$ 8,317,000	\$ 9,051,000
Stock-based compensation charges (1)	(A) (59,000)	(51,000)	(243,000)	(236,000)
Non-GAAP adjusted research and development expense	\$ 2,015,000	\$ 2,347,000	\$ 8,074,000	\$ 8,815,000
Selling and marketing expense				
GAAP selling and marketing expense	\$ 4,265,000	\$ 4,811,000	\$ 18,075,000	\$ 18,284,000
Stock-based compensation charges (1)	(A) (192,000)	(107,000)	(579,000)	(532,000)
Non-GAAP adjusted selling and marketing expense	\$ 4,073,000	\$ 4,704,000	\$ 17,496,000	\$ 17,752,000
General and administrative expense				
GAAP general and administrative expense	\$ 4,241,000	\$ 1,800,000	\$ 10,812,000	\$ 7,938,000
Stock-based compensation charges (1)	(A) (706,000)	(155,000)	(1,170,000)	(734,000)
Strategic consulting and litigation costs (2)	(B) (502,000)	(3,000)	(1,218,000)	(599,000)
Executive separation payment (3)	(C) (1,152,000)	-	(1,152,000)	-
Non-GAAP adjusted general and administrative expense	\$ 1,881,000	\$ 1,642,000	\$ 7,272,000	\$ 6,605,000

# Reconciliation of GAAP to Non-GAAP Financial Measures

Unaudited

	Three Months Ended December 31,		Twelve Months Ended December 31,	
	2015	2014	2015	2014
Operating income:				
GAAP operating income	\$ 1,225,000	\$ 1,651,000	\$ 7,916,000	\$ 6,750,000
Stock-based compensation charges (1)	(A) 1,002,000	347,000	2,173,000	1,682,000
Strategic consulting and litigation costs (2)	(B) 502,000	3,000	1,218,000	599,000
Executive separation payment (3)	(C) 1,152,000	-	1,152,000	-
Non-GAAP adjusted operating income	<u>\$ 3,881,000</u>	<u>\$ 2,001,000</u>	<u>\$ 12,459,000</u>	<u>\$ 9,031,000</u>
Adjusted Operating Margin	27.1%	15.6%	22.8%	17.9%
Net income:				
GAAP net income	\$ 798,000	\$ 904,000	\$ 5,016,000	\$ 4,103,000
Stock-based compensation charges (1)	(A) 1,002,000	347,000	2,173,000	1,682,000
Strategic consulting and litigation costs (2)	(B) 502,000	3,000	1,218,000	599,000
Executive separation payment (3)	(C) 1,152,000	-	1,152,000	-
Income tax impact	(D) 574,000	726,000	2,744,000	2,396,000
Non-GAAP adjusted net income	<u>\$ 4,028,000</u>	<u>\$ 1,980,000</u>	<u>\$ 12,303,000</u>	<u>\$ 8,780,000</u>
Diluted net income per common share:				
GAAP net income	\$ 0.01	\$ 0.02	\$ 0.09	\$ 0.07
Adjustments per share	(A-D) \$ 0.06	\$ 0.01	\$ 0.12	\$ 0.08
Non-GAAP adjusted net income	<u>\$ 0.07</u>	<u>\$ 0.03</u>	<u>\$ 0.21</u>	<u>\$ 0.15</u>
Shares used to compute Non-GAAP adjusted net income per share - diluted	<u>56,554,355</u>	<u>57,043,838</u>	<u>57,476,006</u>	<u>58,966,625</u>

# Reconciliation of GAAP Net Income to Non-GAAP Adjusted EBITDA and Breakdown of Non-GAAP Adjustments

(Unaudited)

The following table provides a reconciliation of GAAP Net Income to Non-GAAP EBITDA, Non-GAAP Adjusted EBITDA and a breakdown of Non-GAAP adjustments including stock based compensation expense, strategic consulting and litigation expense, and executive separation payment costs.

	Three Months Ended December 31,		Twelve Months Ended December 31,	
	2015	2014	2015	2014
<b>Reconciliation of Net income to EBITDA and Adjusted EBITDA:</b>				
Net income	(E) \$ 798,000	\$ 904,000	\$ 5,016,000	\$ 4,103,000
Income tax provision	509,000	790,000	3,144,000	2,830,000
Interest expense	-	-	-	-
Depreciation expense	533,000	413,000	2,152,000	1,622,000
EBITDA	<u>1,840,000</u>	<u>2,107,000</u>	<u>10,312,000</u>	<u>8,555,000</u>
<b>Adjustments:</b>				
Share-based compensation expense	(A) 1,002,000	347,000	2,173,000	1,682,000
Strategic consulting and litigation costs (2)	(B) 502,000	3,000	1,218,000	599,000
Executive separation payment (3)	(C) 1,152,000	-	1,152,000	-
<b>Adjusted EBITDA</b>	<u>\$ 4,496,000</u>	<u>\$ 2,457,000</u>	<u>\$ 14,855,000</u>	<u>\$ 10,836,000</u>
Adjusted EBITDA margin	31.4%	19.1%	27.2%	21.5%
(1) Stock-based compensation charges are included as follows:				
Cost of revenues	\$ 45,000	\$ 34,000	\$ 181,000	\$ 180,000
Research and development	59,000	51,000	243,000	236,000
Selling and marketing	192,000	107,000	579,000	532,000
General and administrative	706,000	155,000	1,170,000	734,000
	<u>\$ 1,002,000</u>	<u>\$ 347,000</u>	<u>\$ 2,173,000</u>	<u>\$ 1,682,000</u>
(2) Strategic consulting and litigation costs are included as follows:				
General and administrative	502,000	3,000	1,218,000	599,000
	<u>\$ 502,000</u>	<u>\$ 3,000</u>	<u>\$ 1,218,000</u>	<u>\$ 599,000</u>
(3) Executive separation payment is included as follows:				
General and administrative	1,152,000	-	1,152,000	-
	<u>\$ 1,152,000</u>	<u>\$ -</u>	<u>\$ 1,152,000</u>	<u>\$ -</u>

# Use of Non-GAAP Financial Information

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This presentation includes Non-GAAP measures. Our Non-GAAP measures are not meant to be considered in isolation or as a substitute for comparable GAAP measures and should be read only in conjunction with our consolidated financial statements prepared in accordance with GAAP. For a detailed explanation of the adjustments made to comparable GAAP measures, the reasons why management uses these measures, the usefulness of these measures and the material limitations of these measures, see items (A) through (E) below.

Items (A) through (E) on the "Reconciliation of GAAP to Non-GAAP Financial Measures" table are listed to the right of certain categories under "Gross profit," "Operating income," "Net income," "Net income per share - diluted" and "EBITDA" and correspond to the categories explained in further detail below under (A) through (E).

(A) Non-cash stock-based compensation charges relating to stock option grants, restricted stock, restricted stock units, and performance units awarded to employees and accounted for in accordance with Share-Based Payment accounting guidance. See (1) on previous page for breakdown of stock-based compensation. Because of varying valuation methodologies, subjective assumptions and varying award types, the Company believes that the exclusion of stock-based compensation charges provides for more accurate comparisons to our peer companies and for a more accurate comparison of our financial results to previous periods. Additionally, the Company believes it is useful to investors to understand the specific impact of non-cash stock-based compensation charges on our operating results.

(B) Strategic consulting and litigation costs. See item (2) on previous page for breakdown of strategic consulting and legal costs. The Company's management excludes these costs when evaluating its ongoing performance and/or predicting its earnings trends and therefore excludes these charges on our adjusted operating results.

(C) Executive separation payment relating to CEO employment termination benefits agreement. See item (3) on previous page. The Company's management excludes these costs when evaluating its ongoing performance and/or predicting its earnings trends and therefore excludes these charges on our adjusted operating results.

(D) The Non-GAAP adjustment to the tax provision represents the non-cash tax expense included in the GAAP tax provision, including the current period utilization of deferred tax assets created in previous periods. The remaining provision for income taxes represents expected cash taxes to be paid.

(E) EBITDA represents earnings before interest, taxes, depreciation and amortization. Adjusted EBITDA adds back stock-based compensation charges and non-recurring litigation expenses.

## Revenue, Non-GAAP Adjusted Gross Profit, Non-GAAP Adjusted Operating Profit and Adjusted EBITDA

Revenue (in thousands) (Unaudited)					
	Three Months Ended 12/31/15	Three Months Ended 09/30/15	Three Months Ended 06/30/15	Three Months Ended 03/31/15	Three Months Ended 12/31/14
<b>Zix Email Encryption</b>	\$14,327	\$14,011	\$13,302	\$13,073	\$12,865

Non-GAAP Adjusted Gross Profit (in thousands) (Unaudited)										
	Three Months Ended 12/31/15		Three Months Ended 09/30/15		Three Months Ended 06/30/15		Three Months Ended 03/31/15		Three Months Ended 12/31/14	
<b>Zix Email Encryption</b>	\$11,850	83%	\$11,620	83%	\$10,920	82%	\$10,911	83%	\$10,694	83%

Non-GAAP Adjusted Operating Profit and Adjusted EBITDA (in thousands) (Unaudited)										
	Three Months Ended 12/31/15		Three Months Ended 09/30/15		Three Months Ended 06/30/15		Three Months Ended 03/31/15		Three Months Ended 12/31/14	
<b>Adjusted Operating Income</b>	\$3,881	27%	\$3,843	27%	\$2,261	17%	\$2,475	19%	\$2,001	16%
<b>Adjusted EBITDA</b>	\$4,496	31%	\$4,520	32%	\$2,837	21%	\$3,002	23%	\$2,457	19%