

GAAP/Non-GAAP Reconciliation and Other Management Metrics

4th Quarter 2016



Use of Non-GAAP Financial Information

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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. In addition, in our earnings release we have provided tables to reconcile the Non-GAAP financial measures utilized to GAAP financial measures.

Adjusted Non-GAAP Measures

Our Non-GAAP measures adjust GAAP Cost of revenue, Gross profit, Research and development expense, Selling and marketing expense, General and administrative expense, Operating income, Net income, Net income per share - diluted, and EBITDA for non-cash stock-based compensation expense, and strategic consulting and litigation costs to derive Non-GAAP adjusted Cost of revenue, adjusted Gross profit, adjusted Research and development expense, adjusted Selling and marketing expense, adjusted General and administrative expense, 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.

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 litigation expenses and non-recurring items that impact our ongoing business. See items (A) through (C) below for further information on the current quarter’s reconciling items.

Reconciliation of GAAP to Non-GAAP Financial Measures

4th Quarter 2016 (Unaudited)

ZIX CORPORATION
RECONCILIATION OF GAAP TO NON-GAAP FINANCIAL MEASURES
(Unaudited)

	Three Months Ended December 31,		Twelve Months Ended December 31,	
	2016	2015	2016	2015
Revenue:				
GAAP revenue	\$ 15,578,000	\$ 14,327,000	\$ 60,144,000	\$ 54,713,000
Cost of revenue				
GAAP cost of revenue	\$ 2,709,000	\$ 2,522,000	\$ 10,533,000	\$ 9,593,000
Stock-based compensation charges (1)	(A) (15,000)	(45,000)	(186,000)	(181,000)
Non-GAAP adjusted cost of revenue	<u>\$ 2,694,000</u>	<u>\$ 2,477,000</u>	<u>\$ 10,347,000</u>	<u>\$ 9,412,000</u>
Gross profit:				
GAAP gross profit	\$ 12,869,000	\$ 11,805,000	\$ 49,611,000	\$ 45,120,000
Stock-based compensation charges (1)	(A) 15,000	45,000	186,000	181,000
Non-GAAP adjusted gross profit	<u>\$ 12,884,000</u>	<u>\$ 11,850,000</u>	<u>\$ 49,797,000</u>	<u>\$ 45,301,000</u>
Research and development expense				
GAAP research and development expense	\$ 2,435,000	\$ 2,074,000	\$ 9,553,000	\$ 8,317,000
Stock-based compensation charges (1)	(A) (31,000)	(59,000)	(246,000)	(243,000)
Non-GAAP adjusted research and development expense	<u>\$ 2,404,000</u>	<u>\$ 2,015,000</u>	<u>\$ 9,307,000</u>	<u>\$ 8,074,000</u>
Selling and marketing expense				
GAAP selling and marketing expense	\$ 4,818,000	\$ 4,265,000	\$ 19,015,000	\$ 18,075,000
Stock-based compensation charges (1)	(A) (81,000)	(192,000)	(542,000)	(579,000)
Non-GAAP adjusted selling and marketing expense	<u>\$ 4,737,000</u>	<u>\$ 4,073,000</u>	<u>\$ 18,473,000</u>	<u>\$ 17,496,000</u>
General and administrative expense				
GAAP general and administrative expense	\$ 2,268,000	\$ 4,241,000	\$ 11,727,000	\$ 10,812,000
Stock-based compensation charges (1)	(A) (122,000)	(706,000)	(809,000)	(1,170,000)
Strategic consulting and litigation costs (2)	(B) (229,000)	(502,000)	(2,865,000)	(1,218,000)
Executive separation payment (3)	(C) -	(1,152,000)	(358,000)	(1,152,000)
Non-GAAP adjusted general and administrative expense	<u>\$ 1,917,000</u>	<u>\$ 1,881,000</u>	<u>\$ 7,695,000</u>	<u>\$ 7,272,000</u>

Note – referenced footnotes (1) – (2) can be found on the following page and (A) – (D) on page 4

Reconciliation of GAAP to Non-GAAP Financial Measures

4th Quarter 2016 (Unaudited)

	Three Months Ended December 31,		Twelve Months Ended December 31,	
	2016	2015	2016	2015
Operating income:				
GAAP operating income	\$ 3,348,000	\$ 1,225,000	\$ 9,316,000	\$ 7,916,000
Stock-based compensation charges (1)	(A) 249,000	1,002,000	1,783,000	2,173,000
Strategic consulting and litigation costs (2)	(B) 229,000	502,000	2,865,000	1,218,000
Executive separation payment (3)	(C) -	1,152,000	358,000	1,152,000
Non-GAAP adjusted operating income	<u>\$ 3,826,000</u>	<u>\$ 3,881,000</u>	<u>\$ 14,322,000</u>	<u>\$ 12,459,000</u>
Adjusted Operating Margin	24.6%	27.1%	23.8%	22.8%
Net income:				
GAAP net income	\$ 1,938,000	\$ 798,000	\$ 5,837,000	\$ 5,016,000
Stock-based compensation charges (1)	(A) 249,000	1,002,000	1,783,000	2,173,000
Strategic consulting and litigation costs (2)	(B) 229,000	502,000	2,865,000	1,218,000
Executive separation payment (3)	(C) -	1,152,000	358,000	1,152,000
Income tax impact	(D) 1,328,000	574,000	3,187,000	2,744,000
Non-GAAP adjusted net income	<u>\$ 3,744,000</u>	<u>\$ 4,028,000</u>	<u>\$ 14,030,000</u>	<u>\$ 12,303,000</u>
Diluted net income per common share:				
GAAP net income	\$ 0.04	\$ 0.01	\$ 0.11	\$ 0.09
Adjustments per share	(A-D) \$ 0.03	\$ 0.06	\$ 0.15	\$ 0.12
Non-GAAP adjusted net income	<u>\$ 0.07</u>	<u>\$ 0.07</u>	<u>\$ 0.26</u>	<u>\$ 0.21</u>
Shares used to compute Non-GAAP adjusted net income per share - diluted	<u>53,490,290</u>	<u>56,554,355</u>	<u>54,395,145</u>	<u>57,476,006</u>

Note – referenced footnotes (1) – (2) can be found on the following page and (A) – (D) on page 4

Reconciliation of GAAP to Non-GAAP Financial Measures

4th Quarter 2016 (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,	
	2016	2015	2016	2015
Reconciliation of Net income to EBITDA and Adjusted EBITDA:				
Net income	(E) \$ 1,938,000	\$ 798,000	\$ 5,837,000	\$ 5,016,000
Income tax provision	1,440,000	509,000	3,692,000	3,144,000
Interest expense	31,000	-	33,000	-
Depreciation expense	643,000	533,000	2,303,000	2,152,000
EBITDA	4,052,000	1,840,000	11,865,000	10,312,000
Adjustments:				
Share-based compensation expense	(A) 249,000	1,002,000	1,783,000	2,173,000
Strategic consulting and litigation costs (2)	(B) 229,000	502,000	2,865,000	1,218,000
Executive separation payment (3)	(C) -	1,152,000	358,000	1,152,000
Adjusted EBITDA	\$ 4,530,000	\$ 4,496,000	\$ 16,871,000	\$ 14,855,000
Adjusted EBITDA margin	29.1%	31.4%	28.1%	27.2%
(1) Stock-based compensation charges are included as follows:				
Cost of revenues	\$ 15,000	\$ 45,000	\$ 186,000	\$ 181,000
Research and development	31,000	59,000	246,000	243,000
Selling and marketing	81,000	192,000	542,000	579,000
General and administrative	122,000	706,000	809,000	1,170,000
	\$ 249,000	\$ 1,002,000	\$ 1,783,000	\$ 2,173,000
(2) Strategic consulting and litigation costs are included as follows:				
General and administrative	229,000	502,000	2,865,000	1,218,000
	\$ 229,000	\$ 502,000	\$ 2,865,000	\$ 1,218,000
(3) Executive separation payment is included as follows:				
General and administrative	-	1,152,000	358,000	1,152,000
	\$ -	\$ 1,152,000	\$ 358,000	\$ 1,152,000

Note – referenced footnotes (1) – (2) can be found on the following page and (A) – (D) on page 4

Use of Non-GAAP Financial Information

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 (D) 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 (D).

(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 CFO 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.

Historical Data

Revenue (in thousands) (Unaudited)

	Three Months Ended 12/31/16	Three Months Ended 09/30/16	Three Months Ended 06/30/16	Three Months Ended 03/31/16	Three Months Ended 12/31/15
Zix Email Encryption	\$15,578	\$15,308	\$14,930	\$14,328	\$14,327

Additional Metrics (in thousands) (Unaudited)

	Three Months Ended 12/31/16		Three Months Ended 09/30/16		Three Months Ended 06/30/16		Three Months Ended 03/31/16		Three Months Ended 12/31/15	
GAAP Gross Profit	\$12,869	83%	\$12,656	83%	\$12,295	82%	\$11,791	82%	\$11,805	82%
GAAP Operating Income	\$3,348	21%	\$2,553	17%	\$946	6%	\$2,468	17%	\$1,225	9%
EBITDA	\$4,052	26%	\$3,189	21%	\$1,560	10%	\$3,061	21%	\$1,840	13%
Non-GAAP Gross Profit	\$12,884	83%	\$12,711	83%	\$12,351	83%	\$11,851	83%	\$11,850	83%
Non-GAAP Operating Income	\$3,826	25%	\$3,668	24%	\$3,317	22%	\$3,509	24%	\$3,881	27%
Adjusted EBITDA	\$4,530	29%	\$4,304	28%	\$3,931	26%	\$4,102	29%	\$4,496	31%