

GAAP/Non-GAAP Reconciliation and Other Management Metrics

1st Quarter 2017



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

1st Quarter 2017 (Unaudited)

		Three Months Ended March 31,	
		2017	2016
Revenue:			
GAAP revenue		\$ 15,893,000	\$ 14,328,000
Cost of revenue			
GAAP cost of revenue		\$ 2,823,000	\$ 2,537,000
Stock-based compensation charges (1)	(A)	(71,000)	(60,000)
Non-GAAP adjusted cost of revenue		\$ 2,752,000	\$ 2,477,000
Gross profit:			
GAAP gross profit		\$ 13,070,000	\$ 11,791,000
Stock-based compensation charges (1)	(A)	71,000	60,000
Non-GAAP adjusted gross profit		\$ 13,141,000	\$ 11,851,000
Research and development expense			
GAAP research and development expense		\$ 2,423,000	\$ 2,179,000
Stock-based compensation charges (1)	(A)	(80,000)	(77,000)
Non-GAAP adjusted research and development expense		\$ 2,343,000	\$ 2,102,000
Selling and marketing expense			
GAAP selling and marketing expense		\$ 5,173,000	\$ 4,409,000
Stock-based compensation charges (1)	(A)	(205,000)	(148,000)
Non-GAAP adjusted selling and marketing expense		\$ 4,968,000	\$ 4,261,000
General and administrative expense			
GAAP general and administrative expense		\$ 2,812,000	\$ 2,735,000
Stock-based compensation charges (1)	(A)	(234,000)	(77,000)
Strategic consulting and litigation costs (2)	(B)	(542,000)	(679,000)
Executive separation payment (3)	(C)	(3,000)	-
Non-GAAP adjusted general and administrative expense		\$ 2,033,000	\$ 1,979,000

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

1st Quarter 2017 (Unaudited)

	Three Months Ended March 31,	
	2017	2016
Operating income:		
GAAP operating income	\$ 2,662,000	\$ 2,468,000
Stock-based compensation charges (1)	(A) 590,000	362,000
Strategic consulting and litigation costs (2)	(B) 542,000	679,000
Executive separation payment (3)	(C) 3,000	-
Non-GAAP adjusted operating income	<u>\$ 3,797,000</u>	<u>\$ 3,509,000</u>
Adjusted Operating Margin	23.9%	24.5%
Net income:		
GAAP net income	\$ 1,775,000	\$ 1,570,000
Stock-based compensation charges (1)	(A) 590,000	362,000
Strategic consulting and litigation costs (2)	(B) 542,000	679,000
Executive separation payment (3)	(C) 3,000	-
Income tax impact	(D) 807,000	820,000
Non-GAAP adjusted net income	<u>\$ 3,717,000</u>	<u>\$ 3,431,000</u>
Diluted net income per common share:		
GAAP net income	\$ 0.03	\$ 0.03
Adjustments per share	(A-D) \$ 0.04	\$ 0.03
Non-GAAP adjusted net income	<u>\$ 0.07</u>	<u>\$ 0.06</u>
Shares used to compute Non-GAAP adjusted net income per share - diluted	<u>53,666,649</u>	<u>56,581,366</u>

Reconciliation of GAAP to Non-GAAP Financial Measures

1st Quarter 2017 (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	
		March 31,	
		2017	2016
Reconciliation of Net income to EBITDA and Adjusted EBITDA:			
	(E)		
Net income		\$ 1,775,000	\$ 1,570,000
Income tax provision		966,000	957,000
Depreciation expense		582,000	534,000
EBITDA		<u>3,323,000</u>	<u>3,061,000</u>
Adjustments:			
Share-based compensation expense	(A)	590,000	362,000
Strategic consulting and litigation costs (2)	(B)	542,000	679,000
Executive separation payment (3)	(C)	3,000	-
Adjusted EBITDA		<u>\$ 4,458,000</u>	<u>\$ 4,102,000</u>
Adjusted EBITDA margin		28.1%	28.6%
(1) Stock-based compensation charges are included as follows:			
Cost of revenues		\$ 71,000	\$ 60,000
Research and development		80,000	77,000
Selling and marketing		205,000	148,000
General and administrative		234,000	77,000
		<u>\$ 590,000</u>	<u>\$ 362,000</u>
(2) Strategic consulting and litigation costs are included as follows:			
General and administrative		542,000	679,000
		<u>\$ 542,000</u>	<u>\$ 679,000</u>
(3) Executive separation payment is included as follows:			
General and administrative		3,000	-
		<u>\$ 3,000</u>	<u>\$ -</u>

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 03/31/17	Three Months Ended 12/31/16	Three Months Ended 09/30/16	Three Months Ended 06/30/16	Three Months Ended 03/31/16
Zix Email Encryption	\$15,893	\$15,578	\$15,308	\$14,930	\$14,328

Additional Metrics (in thousands) (Unaudited)

	Three Months Ended 03/31/17		Three Months Ended 12/31/16		Three Months Ended 09/30/16		Three Months Ended 06/30/16		Three Months Ended 03/31/16	
GAAP Gross Profit	\$13,070	82%	\$12,869	83%	\$12,656	83%	\$12,295	82%	\$11,791	82%
GAAP Operating Income	\$2,662	17%	\$3,348	21%	\$2,553	17%	\$946	6%	\$2,468	17%
EBITDA	\$3,323	21%	\$4,052	26%	\$3,189	21%	\$1,560	10%	\$3,061	21%
Non-GAAP Gross Profit	\$13,141	83%	\$12,884	83%	\$12,711	83%	\$12,351	83%	\$11,851	83%
Non-GAAP Operating Income	\$3,797	24%	\$3,826	25%	\$3,668	24%	\$3,317	22%	\$3,509	24%
Adjusted EBITDA	\$4,458	28%	\$4,530	29%	\$4,304	28%	\$3,931	26%	\$4,102	29%