

GAAP/Non-GAAP Reconciliation and Other Management Metrics

4th 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, strategic consulting, acquisition and litigation costs, intangible amortization costs, executive separation payments, and non-cash tax expense 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, non-cash tax expense and non-recurring items that impact our ongoing business. See items (A) through (E) below for further information on the current quarter’s reconciling items.

Reconciliation of GAAP to Non-GAAP Financial Measures

4th Quarter 2017 (Unaudited)

	Three Months Ended December 31,		Twelve Months Ended December 31,	
	2017	2016	2017	2016
Revenue:				
GAAP revenue	\$ 16,800,000	\$ 15,578,000	\$ 65,663,000	\$ 60,144,000
Cost of revenue				
GAAP cost of revenue	\$ 3,260,000	\$ 2,709,000	\$ 12,602,000	\$ 10,533,000
Stock-based compensation charges (1)	(A) (78,000)	(15,000)	(304,000)	(186,000)
Strategic consulting and litigation costs (2)	(B) -	-	(3,000)	-
Intangible Amortization (3)	(C) (50,000)	-	(150,000)	-
Corporate separation payment (4)	(D) (4,000)	-	(4,000)	-
Non-GAAP adjusted cost of revenue	\$ 3,128,000	\$ 2,694,000	\$ 12,141,000	\$ 10,347,000
Gross profit:				
GAAP gross profit	\$ 13,540,000	\$ 12,869,000	\$ 53,061,000	\$ 49,611,000
Stock-based compensation charges (1)	(A) 78,000	15,000	304,000	186,000
Strategic consulting and litigation costs (2)	(B) -	-	3,000	-
Intangible Amortization (3)	(C) 50,000	-	150,000	-
Corporate separation payment (4)	(D) 4,000	-	4,000	-
Non-GAAP adjusted gross profit	\$ 13,672,000	\$ 12,884,000	\$ 53,522,000	\$ 49,797,000
Research and development expense				
GAAP research and development expense	\$ 2,933,000	\$ 2,435,000	\$ 10,980,000	\$ 9,553,000
Stock-based compensation charges (1)	(A) (98,000)	(31,000)	(374,000)	(246,000)
Strategic consulting and litigation costs (2)	(B) (75,000)	-	(130,000)	-
Corporate separation payment (4)	(D) (43,000)	-	(43,000)	-
Non-GAAP adjusted research and development expense	\$ 2,717,000	\$ 2,404,000	\$ 10,433,000	\$ 9,307,000
Selling and marketing expense				
GAAP selling and marketing expense	\$ 5,225,000	\$ 4,818,000	\$ 20,472,000	\$ 19,015,000
Stock-based compensation charges (1)	(A) (330,000)	(81,000)	(999,000)	(542,000)
Strategic consulting and litigation costs (2)	(B) -	-	(2,000)	-
Intangible Amortization (3)	(C) (56,000)	-	(169,000)	-
Corporate separation payment (4)	(D) (328,000)	-	(328,000)	-
Non-GAAP adjusted selling and marketing expense	\$ 4,511,000	\$ 4,737,000	\$ 18,974,000	\$ 18,473,000
General and administrative expense				
GAAP general and administrative expense	\$ 3,364,000	\$ 2,268,000	\$ 11,399,000	\$ 11,727,000
Stock-based compensation charges (1)	(A) (346,000)	(122,000)	(1,197,000)	(809,000)
Strategic consulting and litigation costs (2)	(B) (494,000)	(229,000)	(1,254,000)	(2,865,000)
Corporate separation payment (4)	(D) (233,000)	-	(236,000)	(358,000)
Non-GAAP adjusted general and administrative expense	\$ 2,291,000	\$ 1,917,000	\$ 8,712,000	\$ 7,695,000

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

Reconciliation of GAAP to Non-GAAP Financial Measures

4th Quarter 2017 (Unaudited)

	Three Months Ended December 31,		Twelve Months Ended December 31,	
	2017	2016	2017	2016
Operating income:				
GAAP operating income	\$ 2,018,000	\$ 3,348,000	\$ 10,210,000	\$ 9,316,000
Stock-based compensation charges (1)	(A) 852,000	249,000	2,874,000	1,783,000
Strategic consulting and litigation costs (2)	(B) 569,000	229,000	1,389,000	2,865,000
Intangible Amortization (3)	(C) 106,000	-	319,000	-
Corporate separation payment (4)	(D) 608,000	-	611,000	358,000
Non-GAAP adjusted operating income	<u>\$ 4,153,000</u>	<u>\$ 3,826,000</u>	<u>\$ 15,403,000</u>	<u>\$ 14,322,000</u>
Adjusted Operating Margin	24.7%	24.6%	23.5%	23.8%
Net income:				
GAAP net income	\$ (12,877,000)	\$ 1,938,000	\$ (8,057,000)	\$ 5,837,000
Stock-based compensation charges (1)	(A) 852,000	249,000	2,874,000	1,783,000
Strategic consulting and litigation costs (2)	(B) 569,000	229,000	1,389,000	2,865,000
Intangible Amortization (3)	(C) 106,000	-	319,000	-
Corporate separation payment (4)	(D) 608,000	-	611,000	358,000
Income tax impact	(E) 15,245,000	1,328,000	18,460,000	3,187,000
Non-GAAP adjusted net income	<u>\$ 4,503,000</u>	<u>\$ 3,744,000</u>	<u>\$ 15,596,000</u>	<u>\$ 14,030,000</u>
Diluted net income per common share:				
GAAP net income per share	\$ (0.24)	\$ 0.04	\$ (0.15)	\$ 0.11
Adjustments per share	(A-E) \$ 0.33	\$ 0.03	\$ 0.44	\$ 0.15
Non-GAAP adjusted net income per share	<u>\$ 0.08</u>	<u>\$ 0.07</u>	<u>\$ 0.29</u>	<u>\$ 0.26</u>
Shares used to compute Non-GAAP adjusted net income per share - diluted	<u>53,391,153</u>	<u>53,490,290</u>	<u>53,430,492</u>	<u>54,395,145</u>

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

Reconciliation of GAAP to Non-GAAP Financial Measures

4th 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, acquisition and litigation expense, and corporate separation payment costs.

	Three Months Ended December 31,		Twelve Months Ended December 31,	
	2017	2016	2017	2016
Reconciliation of Net income to EBITDA and Adjusted EBITDA:				
Net income	\$ (12,877,000)	\$ 1,938,000	\$ (8,057,000)	\$ 5,837,000
Income tax provision	15,003,000	1,440,000	18,606,000	3,692,000
Interest expense	-	31,000	-	33,000
Depreciation	612,000	643,000	2,423,000	2,303,000
Intangible Amortization (3)	106,000	-	319,000	-
EBITDA	2,844,000	4,052,000	13,291,000	11,865,000
Adjustments:				
Stock-based compensation charges (1)	(A) 852,000	249,000	2,874,000	1,783,000
Strategic consulting and litigation costs (2)	(B) 569,000	229,000	1,389,000	2,865,000
Corporate separation payment (4)	(D) 608,000	-	611,000	358,000
Adjusted EBITDA	\$ 4,873,000	\$ 4,530,000	\$ 18,165,000	\$ 16,871,000
Adjusted EBITDA margin	29.0%	29.1%	27.7%	28.1%
(1) Stock-based compensation charges are included as follows:				
Cost of revenues	\$ 78,000	\$ 15,000	\$ 304,000	\$ 186,000
Research and development	98,000	31,000	374,000	246,000
Selling and marketing	330,000	81,000	999,000	542,000
General and administrative	346,000	122,000	1,197,000	809,000
	<u>\$ 852,000</u>	<u>\$ 249,000</u>	<u>\$ 2,874,000</u>	<u>\$ 1,783,000</u>
(2) Strategic consulting, acquisition, and litigation costs are included as follows:				
Cost of revenues	-	-	3,000	-
Research and development	75,000	-	130,000	-
Selling and marketing	-	-	2,000	-
General and administrative	494,000	229,000	1,254,000	2,865,000
	<u>\$ 569,000</u>	<u>\$ 229,000</u>	<u>\$ 1,389,000</u>	<u>\$ 2,865,000</u>
(3) Intangible Amortization is included as follows:				
Cost of revenues	50,000	-	150,000	-
Selling and marketing	56,000	-	169,000	-
	<u>\$ 106,000</u>	<u>\$ -</u>	<u>\$ 319,000</u>	<u>\$ -</u>
(4) Corporate separation payment is included as follows:				
Cost of revenues	4,000	-	4,000	-
Research and development	43,000	-	43,000	-
Selling and marketing	328,000	-	328,000	-
General and administrative	233,000	-	236,000	358,000
	<u>\$ 608,000</u>	<u>\$ -</u>	<u>\$ 611,000</u>	<u>\$ 358,000</u>

Note – referenced footnotes (1) – (4) 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 (F) below.

Items (A) through (F) 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 (F).

(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, acquisition and litigation costs. See item (2) on previous page for breakdown of strategic consulting, acquisition 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) Intangible amortization costs. See item (3) on previous page. The Company's management excludes amortization expenses associated with the acquisition of intangible assets when evaluating its ongoing performance and/or predicting its earnings trends and therefore excludes these charges on our adjusted operating results.

(D) Corporate separation payment relating to employment termination benefits agreement. See item (4) 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.

(E) 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.

(F) 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 12/31/17	Three Months Ended 09/30/17	Three Months Ended 06/30/17	Three Months Ended 03/31/17	Three Months Ended 12/31/16
Zix Email Encryption	\$16,800	\$16,592	\$16,378	\$15,893	\$15,578

Additional Metrics (in thousands) (Unaudited)

	Three Months Ended 09/30/17		Three Months Ended 09/30/17		Three Months Ended 06/30/17		Three Months Ended 03/31/17		Three Months Ended 12/31/16	
GAAP Gross Profit	\$13,540	81%	\$13,320	80%	\$13,131	80%	\$13,070	82%	\$12,869	83%
GAAP Operating Income	\$2,018	12%	\$2,890	17%	\$2,640	16%	\$2,662	17%	\$3,348	21%
EBITDA	\$2,844	17%	\$3,704	22%	\$3,421	21%	\$3,323	21%	\$4,052	26%
Non-GAAP Gross Profit	\$13,672	81%	\$13,449	81%	\$13,260	81%	\$13,141	83%	\$12,884	83%
Non-GAAP Operating Income	\$4,153	25%	\$3,885	23%	\$3,569	22%	\$3,797	24%	\$3,826	25%
Adjusted EBITDA	\$4,873	29%	\$4,592	28%	\$4,243	26%	\$4,458	28%	\$4,530	29%