

GAAP/Non-GAAP Reconciliation and Other Management Metrics

4th Quarter 2020



Use of Non-GAAP Financial Information

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. 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, integration 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 excluding deferred tax (benefit) expense, adjusted Net income per share – diluted, adjusted Net income excluding deferred tax (benefit) expense diluted, and adjusted EBITDA. We provide a reconciliation of these adjusted Non-GAAP measures to GAAP Gross profit, Operating income, Net income, adjusted Net income excluding deferred tax (benefit) expense, Net income per share – diluted, adjusted Net income excluding deferred tax (benefit) expense 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 2020 (Unaudited)

	Three Months Ended December 31,		Twelve Months Ended December 31,	
	2020	2019	2020	2019
Revenue:				
GAAP revenue	\$ 57,867,000	\$ 50,380,000	\$ 218,478,000	\$ 173,428,000
Cost of revenue				
GAAP cost of revenue	\$ 30,498,000	\$ 24,043,000	\$ 112,763,000	\$ 76,908,000
Stock-based compensation charges (1)	(A) (97,000)	(147,000)	(1,201,000)	(569,000)
Strategic consulting and litigation costs (2)	(B) (1,000)	(93,000)	(116,000)	(386,000)
Intangible Amortization (3)	(C) (2,740,000)	(2,660,000)	(10,172,000)	(7,132,000)
Corporate separation payment (4)	(D) -	-	(867,000)	(52,000)
Non-GAAP adjusted cost of revenue	\$ 27,660,000	\$ 21,143,000	\$ 100,407,000	\$ 68,769,000
Gross profit:				
GAAP gross profit	\$ 27,369,000	\$ 26,337,000	\$ 105,715,000	\$ 96,520,000
Stock-based compensation charges (1)	(A) 97,000	147,000	1,201,000	569,000
Strategic consulting and litigation costs (2)	(B) 1,000	93,000	116,000	386,000
Intangible Amortization (3)	(C) 2,740,000	2,660,000	10,172,000	7,132,000
Corporate separation payment (4)	(D) -	-	867,000	52,000
Non-GAAP adjusted gross profit	\$ 30,207,000	\$ 29,237,000	\$ 118,071,000	\$ 104,659,000
Research and development expense				
GAAP research and development expense	\$ 5,887,000	\$ 5,383,000	\$ 22,813,000	\$ 20,431,000
Stock-based compensation charges (1)	(A) (456,000)	(292,000)	(1,641,000)	(1,056,000)
Strategic consulting and litigation costs (2)	(B) (5,000)	(686,000)	(137,000)	(1,481,000)
Intangible Amortization (3)	(C) (76,000)	(76,000)	(303,000)	(303,000)
Corporate separation payment (4)	(D) -	-	(128,000)	(235,000)
Non-GAAP adjusted research and development expense	\$ 5,350,000	\$ 4,329,000	\$ 20,604,000	\$ 17,356,000
Selling and marketing expense				
GAAP selling and marketing expense	\$ 14,191,000	\$ 17,580,000	\$ 56,479,000	\$ 54,903,000
Stock-based compensation charges (1)	(A) (648,000)	(350,000)	(2,524,000)	(1,941,000)
Strategic consulting and litigation costs (2)	(B) (7,000)	(2,175,000)	(219,000)	(3,427,000)
Intangible Amortization (3)	(C) (3,279,000)	(3,433,000)	(12,612,000)	(10,478,000)
Corporate separation payment (4)	(D) (114,000)	(171,000)	(553,000)	(811,000)
Non-GAAP adjusted selling and marketing expense	\$ 10,143,000	\$ 11,451,000	\$ 40,571,000	\$ 38,246,000
General and administrative expense				
GAAP general and administrative expense	\$ 6,096,000	\$ 5,922,000	\$ 21,866,000	\$ 30,327,000
Stock-based compensation charges (1)	(A) (1,160,000)	(636,000)	(4,344,000)	(2,685,000)
Strategic consulting and litigation costs (2)	(B) (973,000)	(1,328,000)	(2,098,000)	(10,755,000)
Corporate separation payment (4)	(D) -	-	(109,000)	(689,000)
Non-GAAP adjusted general and administrative expense	\$ 3,963,000	\$ 3,958,000	\$ 15,315,000	\$ 16,198,000

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 2020 (Unaudited)

	Three Months Ended December 31,		Twelve Months Ended December 31,	
	2020	2019	2020	2019
Operating income:				
GAAP operating income	\$ 1,195,000	\$ (2,548,000)	\$ 4,557,000	\$ (9,141,000)
Stock-based compensation charges (1)	(A) 2,361,000	1,425,000	9,710,000	6,251,000
Strategic consulting and litigation costs (2)	(B) 986,000	4,282,000	2,570,000	16,049,000
Intangible Amortization (3)	(C) 6,095,000	6,169,000	23,087,000	17,913,000
Corporate separation payment (4)	(D) 114,000	171,000	1,657,000	1,787,000
Non-GAAP adjusted operating income	<u>\$ 10,751,000</u>	<u>\$ 9,499,000</u>	<u>\$ 41,581,000</u>	<u>\$ 32,859,000</u>
Adjusted Operating Margin	18.6%	18.9%	19.0%	18.9%
Net income:				
GAAP net (loss) income	\$ (2,945,000)	\$ (3,079,000)	\$ (6,425,000)	\$ (14,647,000)
Stock-based compensation charges (1)	(A) 2,361,000	1,425,000	9,710,000	6,251,000
Strategic consulting and litigation costs (2)	(B) 986,000	4,282,000	2,570,000	16,049,000
Intangible Amortization (3)	(C) 6,095,000	6,169,000	23,087,000	17,913,000
Corporate separation payment (4)	(D) 114,000	171,000	1,657,000	1,787,000
Non-GAAP adjusted net income	<u>\$ 6,611,000</u>	<u>\$ 8,968,000</u>	<u>\$ 30,599,000</u>	<u>\$ 27,353,000</u>
Deferred tax (benefit) expense	1,990,000	(2,236,000)	1,861,000	(4,387,000)
Non-GAAP adjusted net income excluding deferred tax (benefit) expense	<u>\$ 8,601,000</u>	<u>\$ 6,732,000</u>	<u>\$ 32,460,000</u>	<u>\$ 22,966,000</u>
Deemed and accrued dividends on preferred stock	(2,311,000)	(2,090,000)	(9,025,000)	(9,984,000)
Adjusted Net income attributable to common stockholders	<u>\$ 6,290,000</u>	<u>\$ 4,642,000</u>	<u>\$ 23,435,000</u>	<u>\$ 12,982,000</u>
Diluted net income per common share:				
GAAP net income per share before deemed dividends	\$ (0.05)	\$ (0.06)	\$ (0.12)	\$ (0.28)
Adjustments per share	(A-D) \$ 0.18	\$ 0.23	\$ 0.69	\$ 0.80
Non-GAAP adjusted net income per share before deemed dividends	<u>\$ 0.12</u>	<u>\$ 0.17</u>	<u>\$ 0.57</u>	<u>\$ 0.52</u>
Deferred tax (benefit) expense impact to Non-GAAP adjusted net income before deemed dividends per share	(E) \$ 0.04	\$ (0.04)	\$ 0.03	\$ (0.09)
Non-GAAP adjusted net income before deemed dividends per share excluding deferred tax	<u>\$ 0.16</u>	<u>\$ 0.13</u>	<u>\$ 0.60</u>	<u>\$ 0.43</u>
Deemed dividends per share impact to Non-GAAP adjusted net income	\$ (0.04)	\$ (0.04)	\$ (0.17)	\$ (0.19)
Adjusted Net income per share attributable to common stockholders	<u>\$ 0.12</u>	<u>\$ 0.09</u>	<u>\$ 0.43</u>	<u>\$ 0.24</u>
Shares used to compute Non-GAAP adjusted net income per share - diluted	<u>54,291,830</u>	<u>53,199,409</u>	<u>54,024,162</u>	<u>53,025,152</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 2020 (Unaudited)

	Three Months Ended December 31,		Twelve Months Ended December 31,	
	2020	2019	2020	2019
Reconciliation of Net income to EBITDA and Adjusted EBITDA:				
Net income	(F) \$ (2,945,000)	\$ (3,079,000)	\$ (6,425,000)	\$ (14,647,000)
Income tax provision	1,985,000	(2,170,000)	1,740,000	(4,478,000)
Interest expense	2,134,000	2,707,000	9,325,000	10,105,000
Depreciation	1,215,000	1,355,000	5,016,000	4,992,000
Amortization	7,509,000	6,772,000	27,313,000	19,437,000
EBITDA	9,898,000	5,585,000	36,969,000	15,409,000
Adjustments:				
Stock-based compensation charges (1)	(A) 2,361,000	1,425,000	9,710,000	6,251,000
Strategic consulting and litigation costs (2)	(B) 986,000	4,282,000	2,570,000	16,049,000
Corporate separation payment (4)	(D) 114,000	171,000	1,657,000	1,787,000
Adjusted EBITDA	\$ 13,359,000	\$ 11,463,000	\$ 50,906,000	\$ 39,496,000
Adjusted EBITDA margin	23.1%	22.8%	23.3%	22.8%
(1) Stock-based compensation charges are included as follows:				
Cost of revenues	\$ 97,000	\$ 147,000	\$ 1,201,000	\$ 569,000
Research and development	456,000	292,000	1,641,000	1,056,000
Selling and marketing	648,000	350,000	2,524,000	1,941,000
General and administrative	1,160,000	636,000	4,344,000	2,685,000
	\$ 2,361,000	\$ 1,425,000	\$ 9,710,000	\$ 6,251,000
(2) Strategic consulting, acquisition, integration and litigation costs are included as follows:				
Cost of revenues	1,000	93,000	116,000	386,000
Research and development	5,000	686,000	137,000	1,481,000
Selling and marketing	7,000	2,175,000	219,000	3,427,000
General and administrative	973,000	1,328,000	2,098,000	10,755,000
	\$ 986,000	\$ 4,282,000	\$ 2,570,000	\$ 16,049,000
(3) Intangible Amortization is included as follows:				
Cost of revenues	2,740,000	2,660,000	10,172,000	7,132,000
Research and development	76,000	76,000	303,000	303,000
Selling and marketing	3,279,000	3,433,000	12,612,000	10,478,000
	\$ 6,095,000	\$ 6,169,000	\$ 23,087,000	\$ 17,913,000
(4) Corporate separation payment is included as follows:				
Cost of revenues	-	-	867,000	52,000
Research and development	-	-	128,000	235,000
Selling and marketing	114,000	171,000	553,000	811,000
General and administrative	-	-	109,000	689,000
	\$ 114,000	\$ 171,000	\$ 1,657,000	\$ 1,787,000
(5) Net Income tax components:				
Current tax (benefit)/expense	(5,000)	66,000	(121,000)	(91,000)
Deferred tax (benefit)/expense	1,990,000	(2,236,000)	1,861,000	(4,387,000)
	\$ 1,985,000	\$ (2,170,000)	\$ 1,740,000	\$ (4,478,000)

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 excluding deferred tax (benefit) expense," "Net income per share – diluted," "Net income per share excluding deferred tax (benefit) expense- 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, integration and litigation costs. See item (2) on previous page for breakdown of strategic consulting, acquisition, integration 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) Deferred tax expense 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 12/31/20	Three Months Ended 09/30/2020	Three Months Ended 06/30/2020	Three Months Ended 03/31/2020	Three Months Ended 12/31/2019
Zix Email Security	\$57,867	\$54,840	\$53,337	\$52,434	\$50,380

Additional Metrics (in thousands) (Unaudited)

	Three Months Ended 12/31/20		Three Months Ended 09/30/20		Three Months Ended 06/30/20		Three Months Ended 03/31/20		Three Months Ended 12/31/2019	
GAAP Gross Profit	\$27,369	47%	\$26,912	49%	\$25,079	47%	\$26,355	50%	\$26,337	52%
GAAP Operating (Loss) Income	\$1,195	2%	\$2,379	4%	\$43	0%	\$940	2%	(\$2,548)	(5%)
EBITDA	\$9,898	17%	\$10,597	19%	\$7,757	15%	\$8,718	17%	\$5,585	11%
Non-GAAP Gross Profit	\$30,207	52%	\$29,495	54%	\$29,177	55%	\$29,192	56%	\$29,237	58%
Non-GAAP Operating Income	\$10,751	19%	\$11,238	20%	\$10,480	20%	\$9,113	17%	\$9,499	19%
Adjusted EBITDA	\$13,359	23%	\$13,788	25%	\$12,671	24%	\$11,089	21%	\$11,463	23%