
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2020

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number: 001-34511

FORTINET, INC.

(Exact name of registrant as specified in its charter)

Delaware
**(State or other jurisdiction of
incorporation or organization)**

77-0560389
**(I.R.S. Employer
Identification No.)**

899 Kifer Road
Sunnyvale, California 94086
(Address of principal executive offices, including zip code)

(408) 235-7700
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Exchange Act:

Common Stock, \$0.001 Par Value
(Title of each class)

FTNT
(Trading Symbol)

The Nasdaq Stock Market LLC
(Name of exchange on which registered)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 ("Exchange Act") during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Smaller reporting company

Non-accelerated filer

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

As of May 1, 2020, there were 161,648,540 shares of the registrant's common stock outstanding.

FORTINET, INC.
QUARTERLY REPORT ON FORM 10-Q
For the Quarter Ended March 31, 2020
Table of Contents

	<u>Page</u>
PART I—FINANCIAL INFORMATION	
Item 1.	<u>Financial Statements (unaudited)</u> <u>1</u>
	<u>Condensed Consolidated Balance Sheets as of March 31, 2020 and December 31, 2019</u> <u>1</u>
	<u>Condensed Consolidated Statements of Income for the Three Months Ended March 31, 2020 and 2019</u> <u>2</u>
	<u>Condensed Consolidated Statements of Comprehensive Income for the Three Months Ended March 31, 2020 and 2019</u> <u>3</u>
	<u>Condensed Consolidated Statements of Stockholders' Equity for the Three Months Ended March 31, 2020 and 2019</u> <u>4</u>
	<u>Condensed Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2020 and 2019</u> <u>5</u>
	<u>Notes to Condensed Consolidated Financial Statements</u> <u>6</u>
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> <u>22</u>
Item 3.	<u>Quantitative and Qualitative Disclosures about Market Risk</u> <u>33</u>
Item 4.	<u>Controls and Procedures</u> <u>33</u>
PART II—OTHER INFORMATION	
Item 1.	<u>Legal Proceedings</u> <u>34</u>
Item 1A.	<u>Risk Factors</u> <u>34</u>
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u> <u>64</u>
Item 6.	<u>Exhibits</u> <u>65</u>
	<u>Exhibit Index</u> <u>65</u>
	<u>Signatures</u> <u>66</u>

PART I—FINANCIAL INFORMATION

ITEM 1. Financial Statements

FORTINET, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited, in millions, except per share amounts)

	March 31, 2020	December 31, 2019
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 626.1	\$ 1,222.5
Short-term investments	775.2	843.1
Accounts receivable—net	474.7	544.3
Inventory	105.0	117.9
Prepaid expenses and other current assets	54.3	41.2
Total current assets	2,035.3	2,769.0
LONG-TERM INVESTMENTS	172.0	144.3
PROPERTY AND EQUIPMENT—NET	374.2	344.3
DEFERRED CONTRACT COSTS	248.7	237.0
DEFERRED TAX ASSETS	226.5	232.6
GOODWILL	67.2	67.2
OTHER INTANGIBLE ASSETS—NET	27.1	31.1
OTHER ASSETS	55.2	60.0
TOTAL ASSETS	\$ 3,206.2	\$ 3,885.5
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 87.8	\$ 96.4
Accrued liabilities	121.4	101.8
Accrued payroll and compensation	103.6	101.8
Deferred revenue	1,230.2	1,173.6
Total current liabilities	1,543.0	1,473.6
DEFERRED REVENUE	996.6	962.3
INCOME TAX LIABILITIES	81.3	82.8
OTHER LIABILITIES	49.0	44.9
Total liabilities	2,669.9	2,563.6
COMMITMENTS AND CONTINGENCIES (Note 11)		
STOCKHOLDERS' EQUITY:		
Common stock, \$0.001 par value—300 shares authorized; 162.6 and 171.7 shares issued and outstanding at March 31, 2020 and December 31, 2019, respectively	0.2	0.2
Additional paid-in capital	1,128.4	1,180.3
Accumulated other comprehensive income (loss)	(3.1)	1.1
Retained earnings (accumulated deficit)	(589.2)	140.3
Total stockholders' equity	536.3	1,321.9
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 3,206.2	\$ 3,885.5

See notes to condensed consolidated financial statements.

FORTINET, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(unaudited, in millions, except per share amounts)

	Three Months Ended	
	March 31, 2020	March 31, 2019
REVENUE:		
Product	\$ 192.3	\$ 162.7
Service	384.6	309.9
Total revenue	576.9	472.6
COST OF REVENUE:		
Product	76.3	70.2
Service	52.4	42.8
Total cost of revenue	128.7	113.0
GROSS PROFIT:		
Product	116.0	92.5
Service	332.2	267.1
Total gross profit	448.2	359.6
OPERATING EXPENSES:		
Research and development	80.3	68.6
Sales and marketing	260.0	215.9
General and administrative	28.8	24.5
Gain on intellectual property matter	(36.8)	—
Total operating expenses	332.3	309.0
OPERATING INCOME	115.9	50.6
INTEREST INCOME—NET	9.2	10.2
OTHER EXPENSE—NET	(8.0)	(0.5)
INCOME BEFORE INCOME TAXES	117.1	60.3
PROVISION FOR INCOME TAXES	13.1	1.5
NET INCOME	\$ 104.0	\$ 58.8
Net income per share (Note 8):		
Basic	\$ 0.61	\$ 0.35
Diluted	\$ 0.60	\$ 0.34
Weighted-average shares outstanding:		
Basic	170.6	170.2
Diluted	174.2	174.8

See notes to condensed consolidated financial statements.

FORTINET, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited, in millions)

	Three Months Ended	
	March 31, 2020	March 31, 2019
Net income	\$ 104.0	\$ 58.8
Other comprehensive income (loss):		
Change in unrealized gains (losses) on investments	(5.2)	1.0
Less: tax provision (benefit) related to change in unrealized gains (losses) on investments	(1.0)	0.3
Other comprehensive income (loss)	(4.2)	0.7
Comprehensive income	\$ 99.8	\$ 59.5

See notes to condensed consolidated financial statements.

FORTINET, INC.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(unaudited, in millions)

Three Months Ended March 31, 2020							
	Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings (Accumulated Deficit)	Total Stockholders' Equity	
	Shares	Amount					
BALANCE—December 31, 2019	171.7	\$ 0.2	\$ 1,180.3	\$ 1.1	\$ 140.3	\$ 1,321.9	
Issuance of common stock in connection with equity incentive plans - net of tax withholding	0.9	—	(30.3)	—	—	(30.3)	
Repurchase and retirement of common stock	(10.0)	—	(66.4)	—	(833.5)	(899.9)	
Stock-based compensation expense	—	—	44.8	—	—	44.8	
Net unrealized gain (loss) on investments - net of tax	—	—	—	(4.2)	—	(4.2)	
Net income	—	—	—	—	104.0	104.0	
BALANCE—March 31, 2020	162.6	\$ 0.2	\$ 1,128.4	\$ (3.1)	\$ (589.2)	\$ 536.3	

Three Months Ended March 31, 2019							
	Common Stock		Additional Paid-In Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total Stockholders' Equity	
	Shares	Amount					
BALANCE—December 31, 2018	169.8	\$ 0.2	\$ 1,068.3	\$ (0.8)	\$ (57.5)	\$ 1,010.2	
Issuance of common stock in connection with equity incentive plans - net of tax withholding	1.7	—	1.6	—	—	1.6	
Repurchase and retirement of common stock	(0.8)	—	(4.8)	—	(51.4)	(56.2)	
Stock-based compensation expense	—	—	43.0	—	—	43.0	
Cumulative-effect adjustment from adoption of ASU 2018-02	—	—	—	(0.1)	0.1	—	
Net unrealized gain (loss) on investments - net of tax	—	—	—	0.7	—	0.7	
Net income	—	—	—	—	58.8	58.8	
BALANCE—March 31, 2019	170.7	\$ 0.2	\$ 1,108.1	\$ (0.2)	\$ (50.0)	\$ 1,058.1	

See notes to condensed consolidated financial statements.

FORTINET, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited, in millions)

	Three Months Ended	
	March 31, 2020	March 31, 2019
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 104.0	\$ 58.8
Adjustments to reconcile net income to net cash provided by operating activities:		
Stock-based compensation	44.8	43.0
Amortization of deferred contract costs	31.3	25.1
Depreciation and amortization	17.6	15.7
Amortization of investment premiums (discounts)	(0.6)	(1.1)
Other	4.3	0.3
Changes in operating assets and liabilities:		
Accounts receivable—net	69.6	63.6
Inventory	6.7	(2.6)
Prepaid expenses and other current assets	(12.9)	(5.9)
Deferred contract costs	(43.0)	(32.9)
Deferred tax assets	7.1	(8.0)
Other assets	0.9	0.1
Accounts payable	(9.0)	(18.0)
Accrued liabilities	1.8	3.2
Accrued payroll and compensation	1.8	(18.1)
Other liabilities	4.1	(0.9)
Deferred revenue	90.9	79.0
Net cash provided by operating activities	<u>319.4</u>	<u>201.3</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of investments	(368.3)	(264.5)
Sales of investments	126.8	8.1
Maturities of investments	277.2	227.6
Purchases of property and equipment	(27.6)	(10.2)
Payments made in connection with business combination, net of cash acquired	(3.1)	—
Other	(0.4)	—
Net cash provided by (used in) investing activities	<u>4.6</u>	<u>(39.0)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repurchase and retirement of common stock	(889.9)	(60.4)
Proceeds from issuance of common stock	7.4	34.6
Taxes paid related to net share settlement of equity awards	(37.8)	(32.0)
Other	(0.1)	—
Net cash used in financing activities	<u>(920.4)</u>	<u>(57.8)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(596.4)	104.5
CASH AND CASH EQUIVALENTS—Beginning of period	1,222.5	1,112.4
CASH AND CASH EQUIVALENTS—End of period	<u>\$ 626.1</u>	<u>\$ 1,216.9</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Operating lease liabilities arising from obtaining right-of-use assets	\$ 2.4	\$ 3.5
Cash paid to settle liability incurred for repurchase of common stock	\$ —	\$ 4.2
NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Transfers of evaluation units from inventory to property and equipment	\$ 6.3	\$ 4.3
Liability for purchase of property and equipment and asset retirement obligations	\$ 25.9	\$ 7.6
Liability incurred for repurchase of common stock	<u>\$ 10.0</u>	<u>\$ —</u>

See notes to condensed consolidated financial statements.

FORTINET, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Preparation—The unaudited condensed consolidated financial statements of Fortinet, Inc. and its wholly owned subsidiaries (collectively, “we,” “us” or “our”) have been prepared in accordance with generally accepted accounting principles in the United States (“GAAP”) for interim financial information, as well as the instructions to Form 10-Q pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (the “SEC”). Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements, and should be read in conjunction with our audited consolidated financial statements as of and for the year ended December 31, 2019, contained in our Annual Report on Form 10-K filed with the SEC on February 26, 2020. In the opinion of management, all adjustments, which includes normal recurring adjustments, considered necessary for a fair presentation have been included. All intercompany balances, transactions and cash flows have been eliminated. The results of operations for the three months ended March 31, 2020 are not necessarily indicative of the results for the full year or for any future periods. The condensed consolidated balance sheet as of December 31, 2019 is derived from the audited consolidated financial statements for the year ended December 31, 2019. For 2020, the amounts previously reported as Income taxes payable are included in Accrued liabilities. Prior periods have been reclassified to conform with current period presentation.

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates.

There have been no material changes to our significant accounting policies as of and for the three months ended March 31, 2020.

Recently Adopted Accounting Standards

Financial Instruments

In June 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-13—Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (“Topic 326”), which provides guidance on how an entity should measure credit losses on financial instruments. The standard replaces the existing incurred loss model with an expected credit loss model for financial assets measured at amortized cost, including trade receivables, and requires that credit losses on available-for-sale debt securities be presented as an allowance rather than as a write-down. The new approach to estimating credit losses (referred to as the current expected credit losses model) generally accelerates recognition of credit losses. We adopted Topic 326 on January 1, 2020 using the modified retrospective method. The adoption of this standard did not have a material impact on our condensed consolidated financial statements.

Cloud Computing

In August 2018, the FASB issued ASU 2018-15—Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract, which requires a customer in a cloud computing arrangement that is a service contract to follow the internal-use software guidance in Accounting Standards Codification (“ASC”) Topic 350, Intangibles—Goodwill and Other, to determine which implementation costs to capitalize as assets or expense as incurred. We adopted ASU 2018-15 on January 1, 2020. The adoption of this standard did not have a material impact on our condensed consolidated financial statements.

Fair Value Measurements

In August 2018, the FASB issued ASU 2018-13—Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement, which eliminates, adds and modifies certain disclosure requirements for fair value measurements in ASC 820, Fair Value Measurement, as part of its disclosure framework project. We adopted ASU 2018-13 on January 1, 2020. The adoption of this standard did not have a material impact on our disclosures.

FORTINET, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Recent Accounting Standards Not Yet Effective

Income Taxes

In December 2019, the FASB issued ASU 2019-12—Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes. The amendments in ASU 2019-12 simplify the accounting for income taxes by removing certain exceptions to the general principles in Topic 740. The amendments also improve consistent application and simplification of GAAP for other areas of Topic 740 by clarifying and amending existing guidance. ASU 2019-12 is effective for us beginning on January 1, 2021. Early adoption of the amendments is permitted. We are currently evaluating the impact of ASU 2019-12 on our condensed consolidated financial statements.

2. REVENUE RECOGNITION

Our revenue consists of product and service revenue. Product revenue is generated by sales of our FortiGate products and other hardware and software solutions. Service revenue relates to sales of our FortiGuard security subscription, FortiCare technical support services and other services.

Disaggregation of Revenue

The following table presents our revenue disaggregated by major product and service lines (in millions):

	Three Months Ended	
	March 31, 2020	March 31, 2019
Product	\$ 192.3	\$ 162.7
Service:		
Security subscription	211.4	169.6
Technical support and other	173.2	140.3
Total service revenue	384.6	309.9
Total revenue	\$ 576.9	\$ 472.6

Deferred Revenue

During the three months ended March 31, 2020 and March 31, 2019, we recognized \$348.9 million and \$288.6 million in service revenue that was included in the deferred revenue balance as of December 31, 2019 and December 31, 2018, respectively.

Transaction Price Allocated to the Remaining Performance Obligations

As of March 31, 2020, the aggregate amount of the transaction price allocated to remaining performance obligations was \$2.23 billion, which was substantially comprised of deferred security subscription and technical support services revenue. We expect to recognize approximately \$1.23 billion as revenue over the next 12 months and the remainder thereafter.

Accounts Receivable

Trade accounts receivable are recorded at the invoiced amount. On January 1, 2020, we adopted Topic 326, which provides guidance on how to measure credit losses on financial instruments, including accounts receivable. Prior to our adoption of Topic 326, our accounts receivable balance was reduced by an allowance for doubtful accounts that we determined based on our assessment of the collectability of customer accounts. Under Topic 326, our accounts receivable balance is reduced by an allowance for credit losses. We measure expected credit losses of accounts receivable on a collective (pool) basis, aggregating accounts receivable that are either current or no more than 60 days past due, and aggregating accounts receivable that are more than 60 days past due. We apply a credit-loss percentage to each of the pools that is based on our historical credit losses. We review whether each of our significant accounts receivable that is more than 60 days past due continues to exhibit

FORTINET, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

similar risk characteristics with the other accounts receivable in the pool. If we determine that it does not, we evaluate it for expected credit losses on an individual basis.

The COVID-19 pandemic and the recent economic downturn prompted us to perform additional credit reviews of our existing customers, including obtaining recent credit reports and reviewing their latest available statements of financial position. After performing our additional reviews, we determined that, while there may be delays in our collections, the risk of credit loss on our trade accounts receivable as of March 31, 2020 was expected to be consistent with prior periods and that our methodology for estimating credit losses was appropriate.

The allowance for credit losses was \$1.1 million as of March 31, 2020, and the allowance for doubtful accounts was \$1.2 million as of December 31, 2019. Provisions, write-offs and recoveries were not material during the three months ended March 31, 2020.

Deferred Contract Costs

Sales commissions earned by our sales force are considered incremental and recoverable costs of obtaining a contract with a customer. The amortization of deferred contract costs is included in sales and marketing expense in our condensed consolidated statements of income. Amortization of deferred contract costs during the three months ended March 31, 2020 and March 31, 2019 were \$31.3 million and \$25.1 million, respectively.

3. FINANCIAL INSTRUMENTS AND FAIR VALUE

The following tables summarize our investments (in millions):

	March 31, 2020			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Corporate debt securities	\$ 616.3	\$ 0.3	\$ (4.2)	\$ 612.4
Commercial paper	150.6	0.1	(0.1)	150.6
U.S. government securities	96.6	0.5	—	97.1
Certificates of deposit and term deposits ⁽¹⁾	87.7	0.1	(0.7)	87.1
Total available-for-sale securities	<u>\$ 951.2</u>	<u>\$ 1.0</u>	<u>\$ (5.0)</u>	<u>\$ 947.2</u>

	December 31, 2019			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Corporate debt securities	\$ 576.1	\$ 1.0	\$ (0.1)	\$ 577.0
Commercial paper	148.7	0.1	—	148.8
U.S. government securities	195.0	0.2	—	195.2
Certificates of deposit and term deposits ⁽¹⁾	66.4	—	—	66.4
Total available-for-sale securities	<u>\$ 986.2</u>	<u>\$ 1.3</u>	<u>\$ (0.1)</u>	<u>\$ 987.4</u>

⁽¹⁾ The majority of our certificates of deposit and term deposits are foreign deposits.

FORTINET, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following tables show the gross unrealized losses and the related fair values of our investments that have been in a continuous unrealized loss position (in millions):

	March 31, 2020					
	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Corporate debt securities	\$ 475.2	\$ (4.2)	\$ 7.1	\$ —	\$ 482.3	\$ (4.2)
Commercial paper	45.5	(0.1)	—	—	45.5	(0.1)
Certificates of deposit and term deposits	49.1	(0.7)	—	—	49.1	(0.7)
Total available-for-sale securities	<u>\$ 569.8</u>	<u>\$ (5.0)</u>	<u>\$ 7.1</u>	<u>\$ —</u>	<u>\$ 576.9</u>	<u>\$ (5.0)</u>

	December 31, 2019					
	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Corporate debt securities	\$ 117.3	\$ (0.1)	\$ 16.1	\$ —	\$ 133.4	\$ (0.1)
Commercial paper	26.0	—	—	—	26.0	—
U.S. government securities	47.1	—	—	—	47.1	—
Certificates of deposit and term deposits	13.0	—	—	—	13.0	—
Total available-for-sale securities	<u>\$ 203.4</u>	<u>\$ (0.1)</u>	<u>\$ 16.1</u>	<u>\$ —</u>	<u>\$ 219.5</u>	<u>\$ (0.1)</u>

The contractual maturities of our investments were as follows (in millions):

	March 31, 2020	December 31, 2019
Due within one year	\$ 775.2	\$ 843.1
Due within one to three years	172.0	144.3
Total	<u>\$ 947.2</u>	<u>\$ 987.4</u>

Available-for-sale securities are reported at fair value, with unrealized gains and losses and the related tax impact included as a separate component of stockholders' equity and in comprehensive income. Accrued interest of \$4.7 million as of March 31, 2020 is excluded from both the fair value and the amortized cost of our available-for-sale securities and is recorded in Prepaid expenses and other current assets in our condensed consolidated balance sheet. We have elected to not record an allowance for credit losses for accrued interest for available-for-sale securities and will reverse the accrued interest against interest income in the period in which we determine the accrued interest to be uncollectible.

Prior to 2020, we followed the guidance in ASC 320 Investments—Debt and Equity Securities in determining whether unrealized losses were other than temporary. We adopted Topic 326 on January 1, 2020, and now consider whether unrealized losses have resulted from a credit loss or other factors. The unrealized losses on our available-for-sale securities as of March 31, 2020 and as of December 31, 2019 were caused by fluctuations in market value and interest rates as a result of the economic environment. We concluded that an allowance for credit losses was unnecessary as of March 31, 2020 and that the impairments as of December 31, 2019 were not other than temporary because (i) the decline in market value was attributable to changes in market conditions and not credit quality, and (ii) we concluded that neither do we intend to sell nor is it more likely than not that we will be required to sell these investments prior to recovery of their amortized cost basis.

Realized losses on available-for-sale securities were insignificant in the periods presented and are included in Other expense—net in our consolidated statements of income. We use the specific identification method to determine the cost basis of investments sold.

FORTINET, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Fair Value Accounting—We apply the following fair value hierarchy for disclosure of the inputs used to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows:

Level 1—Inputs are unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2—Inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the assets or liabilities, either directly or indirectly through market corroboration, for substantially the full term of the financial instruments.

Level 3—Unobservable inputs based on our own assumptions used to measure assets and liabilities at fair value. The inputs require significant management judgment or estimation.

We measure the fair value of money market funds and certain U.S. government securities using quoted prices in active markets for identical assets. The fair value of all other financial instruments was based on quoted prices for similar assets in active markets, or model-driven valuations using significant inputs derived from or corroborated by observable market data.

We classify investments within Level 1 if quoted prices are available in active markets for identical securities.

We classify items within Level 2 if the investments are valued using model-driven valuations using observable inputs such as quoted market prices, benchmark yields, reported trades, broker/dealer quotes or alternative pricing sources with reasonable levels of price transparency. Investments are held by custodians who obtain investment prices from a third-party pricing provider that incorporates standard inputs in various asset price models.

Fair Value of Financial Instruments

Assets Measured at Fair Value on a Recurring Basis

The following tables present the fair value of our financial assets measured at fair value on a recurring basis as of March 31, 2020 and December 31, 2019 (in millions):

	March 31, 2020				December 31, 2019			
	Aggregate Fair Value	Quoted Prices in Active Markets For Identical Assets	Significant Other Observable Remaining Inputs	Significant Other Unobservable Remaining Inputs	Aggregate Fair Value	Quoted Prices in Active Markets For Identical Assets	Significant Other Observable Remaining Inputs	Significant Other Unobservable Remaining Inputs
		(Level 1)	(Level 2)	(Level 3)		(Level 1)	(Level 2)	(Level 3)
Assets:								
Corporate debt securities	\$ 613.4	\$ —	\$ 613.4	\$ —	\$ 577.0	\$ —	\$ 577.0	\$ —
Commercial paper	164.6	—	164.6	—	165.8	—	165.8	—
Certificates of deposit and term deposits	87.1	—	87.1	—	66.4	—	66.4	—
U.S. government securities	97.1	97.1	—	—	195.2	195.2	—	—
Money market funds	163.7	163.7	—	—	15.0	15.0	—	—
Total	\$ 1,125.9	\$ 260.8	\$ 865.1	\$ —	\$ 1,019.4	\$ 210.2	\$ 809.2	\$ —
Reported as:								
Cash equivalents	\$ 178.7				\$ 32.0			
Short-term investments	775.2				843.1			
Long-term investments	172.0				144.3			
Total	\$ 1,125.9				\$ 1,019.4			

FORTINET, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

There were no transfers between Level 1 and Level 2 of the fair value hierarchy during the three months ended March 31, 2020 and year ended December 31, 2019.

4. INVENTORY

Inventory consisted of the following (in millions):

	March 31, 2020	December 31, 2019
Raw materials	\$ 12.5	\$ 9.7
Finished goods	92.5	108.2
Inventory	<u>\$ 105.0</u>	<u>\$ 117.9</u>

5. PROPERTY AND EQUIPMENT—Net

Property and equipment—net consisted of the following (in millions):

	March 31, 2020	December 31, 2019
Land	\$ 93.3	\$ 93.3
Building and building improvements	148.0	147.4
Computer equipment and software	121.7	116.7
Leasehold improvements	26.8	25.5
Evaluation units	22.4	19.9
Furniture and fixtures	18.2	17.3
Construction-in-progress	90.7	61.2
Total property and equipment	521.1	481.3
Less: accumulated depreciation	(146.9)	(137.0)
Property and equipment—net	<u>\$ 374.2</u>	<u>\$ 344.3</u>

Depreciation expense was \$13.6 million and \$12.7 million during the three months ended March 31, 2020 and March 31, 2019, respectively.

6. INVESTMENTS IN PRIVATELY HELD COMPANIES

Our investments in the equity securities of privately held companies totaled \$1.0 million and \$5.3 million as of March 31, 2020 and December 31, 2019, respectively. These investments are accounted for at cost, adjusted for changes in observable prices minus impairment. We own less than 20% of the voting securities in each of these investments and do not have the ability to exercise significant influence over operating and financial policies of the respective entities. These investments are recorded as Other assets in our condensed consolidated balance sheets and would be measured at fair value if indicators of an increase in value or impairment existed. During the three months ended March 31, 2020, we determined that one investment was impaired. As a result, we recognized and included a non-cash impairment charge of \$4.3 million in Other expense—net in our condensed consolidated statements of income. As of March 31, 2020, no other events have occurred that would affect the carrying value of these investments.

7. GOODWILL AND OTHER INTANGIBLE ASSETS—Net

Goodwill

As of March 31, 2020 and December 31, 2019, we had goodwill of \$67.2 million. There were no impairments to goodwill during the three months ended March 31, 2020 or during prior periods.

FORTINET, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Other Intangible Assets—Net

The following tables present other intangible assets—net as of March 31, 2020 and December 31, 2019 (in millions, except years):

	March 31, 2020			
	Weighted-Average Useful Life (in Years)	Gross	Accumulated Amortization	Net
Other intangible assets—net:				
Finite-lived intangible assets:				
Developed technologies	4.0	\$ 48.8	\$ 25.8	\$ 23.0
Customer relationships	4.1	21.6	17.5	4.1
Total other intangible assets—net		<u>\$ 70.4</u>	<u>\$ 43.3</u>	<u>\$ 27.1</u>

	December 31, 2019			
	Weighted-Average Useful Life (in Years)	Gross	Accumulated Amortization	Net
Other intangible assets—net:				
Finite-lived intangible assets:				
Developed technologies	4.0	\$ 50.2	\$ 24.6	\$ 25.6
Customer relationships	4.1	21.6	16.1	5.5
Total other intangible assets—net		<u>\$ 71.8</u>	<u>\$ 40.7</u>	<u>\$ 31.1</u>

Amortization expense was \$4.0 million and \$3.0 million during the three months ended March 31, 2020 and March 31, 2019, respectively.

The following table summarizes estimated future amortization expense of finite-lived intangible assets—net (in millions):

	Amount
Years:	
2020 (the remainder of 2020)	\$ 8.7
2021	8.3
2022	6.4
2023	3.7
Total	<u>\$ 27.1</u>

8. NET INCOME PER SHARE

Basic net income per share is computed by dividing net income by the weighted-average number of shares of common stock outstanding during the period. Diluted net income per share is computed by dividing net income by the weighted-average number of shares of common stock outstanding during the period, plus the dilutive effects of restricted stock units (“RSUs”) and stock options. Dilutive shares of common stock are determined by applying the treasury stock method.

FORTINET, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

A reconciliation of the numerator and denominator used in the calculation of basic and diluted net income per share is as follows (in millions, except per share amounts):

	Three Months Ended	
	March 31, 2020	March 31, 2019
Numerator:		
Net income	\$ 104.0	\$ 58.8
Denominator:		
Basic shares:		
Weighted-average common stock outstanding-basic	170.6	170.2
Diluted shares:		
Weighted-average common stock outstanding-basic	170.6	170.2
Effect of potentially dilutive securities:		
RSUs	2.4	3.3
Stock options	1.2	1.3
Weighted-average shares used to compute diluted net income per share	174.2	174.8
Net income per share:		
Basic	\$ 0.61	\$ 0.35
Diluted	\$ 0.60	\$ 0.34

The following weighted-average shares of common stock were excluded from the computation of diluted net income per share for the periods presented, as their effect would have been antidilutive (in millions):

	Three Months Ended	
	March 31, 2020	March 31, 2019
RSUs	0.6	0.7
Stock options	0.3	0.3
Total	0.9	1.0

9. LEASES

We have operating leases for offices, research and development facilities and data centers. Our leases have remaining terms that range from less than one year to approximately seven years, some of which include one or more options to renew, with renewal terms of up to five years. We do not include renewal options in our lease terms for calculating our lease liability, as the renewal options allow us to maintain operational flexibility and we are not reasonably certain we will exercise these renewal options at the time of the lease commencement.

During the year ended December 31, 2019, we entered into a finance lease with \$3.6 million lease liabilities arising from obtaining right-of-use assets with a lease term of approximately two years. Our remaining finance leases were not material to our condensed consolidated financial statements. The related assumptions and further disclosures for finance leases are not material.

FORTINET, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The components of lease expense were as follows (in millions):

	Three Months Ended		Three Months Ended	
	March 31, 2020		March 31, 2019	
Operating lease expense	\$	4.3	\$	3.6
Variable lease expense ⁽¹⁾		0.6		0.6
Short-term lease expense		0.9		0.7
Total lease expense	\$	5.8	\$	4.9

⁽¹⁾ Variable lease expense for the three months ended March 31, 2020 and March 31, 2019 predominantly included common area maintenance charges and parking expense.

Supplemental balance sheet information related to our operating leases was as follows (in millions, except lease term and discount rate):

	Classification	March 31, 2020		December 31, 2019	
			\$	42.7	\$
Operating lease ROU assets - non-current	Other assets				
Operating lease liabilities - current	Accrued liabilities	\$	14.8	\$	15.5
Operating lease liabilities - non-current	Other liabilities		28.3		30.6
Total operating lease liabilities		\$	43.1	\$	46.1
Weighted average remaining lease term in years - operating leases			3.6		3.7
Weighted average discount rate - operating leases			2.8%		2.8%

Supplemental cash flow information related to leases was as follows (in millions):

	Three Months Ended		Three Months Ended	
	March 31, 2020		March 31, 2019	
Cash paid for amounts included in the measurement of lease liabilities				
Operating cash flows used for operating leases	\$	4.6	\$	4.6
Lease liabilities arising from obtaining right-of-use assets				
Operating leases	\$	2.4	\$	3.5

FORTINET, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Maturities of operating lease liabilities as of March 31, 2020 were as follows (in millions):

Year ending December 31,	Amount	
2020 (the remainder of 2020)	\$	11.9
2021		13.6
2022		8.7
2023		5.4
2024		3.9
Thereafter		1.8
Total lease payments		45.3
Less imputed interest		(2.2)
Total	\$	43.1

As of March 31, 2020, we had additional minimum lease payments of \$5.1 million relating to operating leases that had been signed but had not yet commenced and therefore were excluded from the table above. These leases will commence during 2020 and will have lease terms of approximately five to seven years.

10. MUTUAL COVENANT-NOT-TO-SUE AND RELEASE AGREEMENT

In January 2020, we entered into an agreement with a competitor in the network security industry whereby, in February 2020, the competitor party paid us a lump sum of \$50.0 million for a seven-year mutual covenant-not-to-sue for patent claims. Pursuant to this agreement, at the end of this first seven-year period, either party may extend the agreement for an additional seven-year mutual covenant-not-to-sue in return for this competitor paying us an additional \$50.0 million. This agreement arose after expiration of previous agreements between the parties whereby the competitor had paid us sums for a limited term license to certain of our intellectual property (“IP”) and a limited term mutual covenant-not-to-sue.

We concluded that the agreement was a 14-year contract with a total transaction price of \$100.0 million, and that it contained two material distinct performance obligations: (1) the right to use our existing patents, and (2) the right to use any patents that we develop over the term of the contract. We allocated \$36.0 million to the functional patents, which was recognized upon commencement of the contract; the remaining \$64.0 million, representing the right to utilize future patents, will be recognized over the contract term. We further concluded that our existing patents represent functional IP that should be recognized upon granting our competitor access. We also concluded that the right to receive additional functional IP that we will develop in the future represents a stand ready obligation. Therefore, the transaction price allocated to this obligation is recognized ratably over the 14-year contract term. We estimated the stand-alone selling price of each distinct performance obligation and allocated the \$100.0 million transaction price.

During the three months ended March 31, 2020, we recorded \$36.8 million in Gain on IP matter in our condensed consolidated statement of income, consisting of the \$36.0 million allocated to the functional patents and \$0.8 million of amortization of the deferred component. We recorded \$13.2 million in Accrued liabilities and Other liabilities in our condensed consolidated balance sheet as of March 31, 2020.

11. COMMITMENTS AND CONTINGENCIES

The following table summarizes our inventory purchase commitments as of March 31, 2020 (in millions):

	Total	2020	2021	2022	2023	2024	Thereafter
Inventory purchase commitments	\$ 247.2	\$ 247.2	\$ —	\$ —	\$ —	\$ —	\$ —

Inventory Purchase Commitments—Our independent contract manufacturers procure components and build our products based on our forecasts. These forecasts are based on estimates of future demand for our products, which are in turn based on historical trends and an analysis from our sales and marketing organizations, adjusted for overall market conditions. In

FORTINET, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

order to reduce manufacturing lead times and plan for adequate component supply, we may issue purchase orders to some of our independent contract manufacturers, which may not be cancelable. As of March 31, 2020, we had \$247.2 million of open purchase orders with our independent contract manufacturers that may not be cancelable.

Other Contractual Commitments and Open Purchase Orders—In addition to commitments with contract manufacturers, we have open purchase orders and contractual obligations in the ordinary course of business for which we have not received goods or services. As of March 31, 2020, we had \$10.9 million in other contractual commitments having a remaining term in excess of one year that may not be cancelable.

Litigation—We are involved in disputes, litigation, and other legal actions. For lawsuits where we are the defendant, we are in the process of defending these litigation matters, and while there can be no assurances and the outcome of certain of these matters is currently not determinable and not predictable, we currently are unaware of any existing claims or proceedings that we believe are likely to have a material adverse effect on our financial position. There are many uncertainties associated with any litigation and these actions or other third-party claims against us may cause us to incur costly litigation fees, costs and substantial settlement charges, and possibly subject us to damages and other penalties. In addition, the resolution of any IP litigation may require us to make royalty payments, which could adversely affect our gross margins in future periods. If any of those events were to occur, our business, financial condition, results of operations, and cash flows could be adversely affected. Litigation is unpredictable and the actual liability in any such matters may be materially different from our current estimates, which could result in the need to adjust any accrued liability and record additional expenses. We accrue for contingencies when we believe that a loss is probable and that we can reasonably estimate the amount of any such loss.

Indemnification and Other Matters—Under the indemnification provisions of our standard sales contracts, we agree to defend our customers against third-party claims asserting various allegations such as product defects and infringement of certain IP rights, which may include patents, copyrights, trademarks or trade secrets, and to pay judgments entered on such claims. In some contracts, our exposure under these indemnification provisions is limited by the terms of the contracts to certain defined limits, such as the total amount paid by our customer under the agreement. However, certain agreements include covenants, penalties and indemnification provisions including and beyond indemnification for third-party claims of IP infringement, that could potentially expose us to losses in excess of the amount received under the agreement, and in some instances to potential liability that is not contractually limited. To date, although from time to time there are indemnification claims asserted against us and currently there are pending indemnification claims, there have been no material awards under such indemnification provisions.

Periodically, we, like other security companies and companies in other industries, may experience cybersecurity threats, malicious activity directed against our information technology infrastructure and unauthorized attempts to gain access to our and our customers' sensitive information and systems.

12. STOCKHOLDERS' EQUITY

Stock-Based Compensation Plans

We maintain the Amended and Restated Fortinet, Inc. 2009 Equity Incentive Plan (the "Amended Plan") pursuant to which we have granted RSUs and stock options. We also previously had an Employee Stock Purchase Plan ("ESPP") for eligible employees, which was terminated in February 2019. As of March 31, 2020, there was a total of 12.1 million shares of common stock available for grant under the Amended Plan.

FORTINET, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Restricted Stock Units

The following table summarizes the activity and related information for RSUs for the periods presented below (in millions, except per share amounts):

	Restricted Stock Units Outstanding	
	Number of Shares	Weighted-Average Grant Date Fair Value per Share
Balance—December 31, 2019	6.1	\$ 64.56
Granted	1.3	114.33
Forfeited	(0.1)	68.19
Vested	(1.0)	58.17
Balance—March 31, 2020	6.3	\$ 75.96

As of March 31, 2020, total compensation expense related to unvested RSUs granted to employees and non-employees under the 2009 Plan, but not yet recognized, was \$440.8 million. This expense is expected to be amortized on a straight-line basis over a weighted-average vesting period of 2.9 years.

RSUs settle into shares of common stock upon vesting. Upon the vesting of the RSUs, we net-settle the RSUs and withhold a portion of the shares to satisfy minimum statutory employee withholding tax requirements. Total payment of the employees' tax obligations to the tax authorities is reflected as a financing activity within the condensed consolidated statements of cash flows.

The following summarizes the number and value of the shares withheld for employee taxes (in millions):

	Three Months Ended	
	March 31, 2020	March 31, 2019
Shares withheld for taxes	0.3	0.4
Amount withheld for taxes	\$ 37.8	\$ 32.0

Employee Stock Options

The following table summarizes the weighted-average assumptions relating to our employee stock options:

	Three Months Ended	
	March 31, 2020	March 31, 2019
Expected term in years	4.4	4.4
Volatility	33.5%	34.2%
Risk-free interest rate	1.3%	2.5%
Dividend rate	—%	—%

FORTINET, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table summarizes the stock option activity and related information for the periods presented below (in millions, except exercise prices and contractual life):

	Options Outstanding			
	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Balance—December 31, 2019	2.7	\$ 50.37		
Granted	0.5	114.48		
Forfeited	—	59.28		
Exercised	(0.2)	40.02		
Balance—March 31, 2020	3.0	\$ 62.41		
Options vested and expected to vest—March 31, 2020	3.0	\$ 62.41	4.8	\$ 123.8
Options exercisable—March 31, 2020	1.5	\$ 39.50	3.5	\$ 90.3

The aggregate intrinsic value represents the difference between the exercise price of stock options and the quoted market price of our common stock on March 31, 2020 for all in-the-money stock options. As of March 31, 2020, total compensation expense related to unvested stock options granted to employees but not yet recognized was \$38.6 million. This expense is expected to be amortized on a straight-line basis over a weighted-average period of 3.1 years.

Additional information related to our stock options is summarized below (in millions, except per share amounts):

	Three Months Ended	
	March 31, 2020	March 31, 2019
Weighted-average fair value per share granted	\$ 33.82	\$ 27.12
Intrinsic value of options exercised	\$ 13.1	\$ 27.2
Fair value of options vested	\$ 6.0	\$ 4.2

Stock-Based Compensation Expense

Stock-based compensation expense, including stock-based compensation expense related to awards classified as liabilities, is included in costs and expenses as follows (in millions):

	Three Months Ended	
	March 31, 2020	March 31, 2019
Cost of product revenue	\$ 0.4	\$ 0.4
Cost of service revenue	3.0	2.8
Research and development	10.9	9.4
Sales and marketing	25.7	25.4
General and administrative	5.3	5.0
Total stock-based compensation expense	\$ 45.3	\$ 43.0

FORTINET, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The following table summarizes stock-based compensation expense, including stock-based compensation expense related to awards classified as liabilities, by award type (in millions):

	Three Months Ended	
	March 31, 2020	March 31, 2019
RSUs	\$ 42.2	\$ 39.2
Stock options	3.1	2.5
ESPP	—	1.3
Total stock-based compensation expense	<u>\$ 45.3</u>	<u>\$ 43.0</u>

Total income tax benefit associated with stock-based compensation that is recognized in the condensed consolidated statements of income is as follows (in millions):

	Three Months Ended	
	March 31, 2020	March 31, 2019
Income tax benefit associated with stock-based compensation	\$ 10.0	\$ 10.0

Share Repurchase Program

Under the Share Repurchase Program originally approved by our board of directors in January 2016 (the “Repurchase Program”), our board of directors has authorized the repurchase of up to \$2.5 billion of our outstanding common stock through February 28, 2021. Share repurchases may be made by us from time to time in privately negotiated transactions or in open market transactions. The Repurchase Program does not require us to purchase a minimum number of shares, and may be suspended, modified or discontinued at any time without prior notice.

During the three months ended March 31, 2020, we repurchased 10.0 million shares of common stock under the Repurchase Program in open market transactions at an average price of \$90.36 per share and for an aggregate purchase price of \$899.9 million. As of March 31, 2020, \$692.9 million remained available for future share repurchases under the Repurchase Program.

13. INCOME TAXES

Our effective tax rate was 11% for the three months ended March 31, 2020, compared to an effective tax rate of 2% for the same period last year. The effective tax rates for the periods presented are primarily comprised of U.S. federal and state taxes, withholding taxes, foreign taxes and excess tax benefits from stock-based compensation expense. The tax rates for the three months ended March 31, 2020 and March 31, 2019 were impacted by U.S. federal and state taxes, withholding taxes and foreign taxes that were \$28.3 million and \$17.5 million, respectively, which were offset by excess tax benefits from stock-based compensation expense of \$15.2 million and \$16.0 million, respectively. U.S. federal and state taxes were lowered by a tax benefit of \$4.8 million from the foreign-derived intangible income deduction for the three months ended March 31, 2020.

As of March 31, 2020 and December 31, 2019, unrecognized tax benefits were \$65.6 million and \$67.5 million, respectively. If recognized, \$60.4 million of the unrecognized tax benefits would favorably affect our effective tax rate. It is our policy to include accrued interest and penalties related to uncertain tax benefits in income tax expense. As of March 31, 2020 and December 31, 2019, accrued interest and penalties were \$14.5 million and \$14.1 million, respectively. It is reasonably possible that our gross unrecognized tax benefits will decrease by up to \$10.4 million in the next 12 months, due to the lapse of the statute of limitations. This decrease, if recognized, would positively impact our effective tax rate, and would be recognized as additional tax benefits.

We file income tax returns in the U.S. federal jurisdiction and in various U.S. state and foreign jurisdictions. Generally, we are no longer subject to U.S. state and foreign income tax examinations by tax authorities for tax years prior to 2010. We are no longer subject to examination by U.S. federal income tax authorities for tax years prior to 2015. We currently have ongoing tax audits in the United Kingdom, Canada and several other foreign jurisdictions. The focus of these audits is the inter-company profit allocation.

FORTINET, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

On June 7, 2019, the Ninth Circuit overturned the U.S. Tax Court’s decision in *Altera Corporation and Subsidiaries vs. Commissioner of Internal Revenue* (“Altera”) and ruled in favor of the Commissioner, validating the regulations requiring stock-based compensation to be included in a cost sharing arrangement. Due to the uncertainty surrounding the status of the current regulations and questions related to the scope of potential benefits or obligations, we incurred an unrecognized tax benefit of \$8.5 million as of March 31, 2020 related to the Ninth Circuit’s Altera decision regarding stock-based compensation in cost sharing arrangements. We continue to monitor developments in this case and any impact it could have on our tax provision.

On March 27, 2020, the President signed into law the Coronavirus Aid, Relief, and Economic Security Act (the “CARES” Act). The CARES Act provides numerous tax provisions and other stimulus measures, including temporary changes regarding the prior and future utilization of net operating losses, temporary changes to the prior and future limitations on interest deductions, temporary suspension of certain payment requirements for the employer portion of Social Security taxes, technical corrections from prior tax legislation for tax depreciation of certain qualified improvement property and the creation of certain refundable employee retention credits. The Company does not expect there to be a material tax impact on its consolidated financial statements at this time and will continue to assess the implications of the CARES Act and its continuing developments and interpretations.

14. DEFINED CONTRIBUTION PLANS

Our tax-deferred savings plan under our 401(k) Plan permits participating U.S. employees to contribute a portion of their pre-tax or after-tax earnings. In Canada, we have a Group Registered Retirement Savings Plan Program (the “RRSP”), which permits participants to make tax-deductible contributions. Our board of directors approved 50% matching contributions on employee contributions up to 4% of each employee’s eligible earnings. Our matching contributions to our 401(k) Plan and the RRSP for the three months ended March 31, 2020 and March 31, 2019 were \$2.2 million and \$1.7 million, respectively.

15. SEGMENT INFORMATION

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. Our chief operating decision maker is our chief executive officer. Our chief executive officer reviews financial information presented on a consolidated basis, accompanied by information about revenue by geographic region for purposes of allocating resources and evaluating financial performance. We have one business activity, and there are no segment managers who are held accountable for operations, operating results and plans for levels or components below the consolidated unit level. Accordingly, we have determined that we have one operating segment, and therefore, one reportable segment.

Revenue by geographic region is based on the billing address of our customers. The following tables set forth revenue and property and equipment—net by geographic region (in millions):

Revenue	Three Months Ended	
	March 31, 2020	March 31, 2019
Americas:		
United States	\$ 181.6	\$ 150.3
Other Americas	60.6	50.2
Total Americas	242.2	200.5
Europe, Middle East and Africa (“EMEA”)	220.7	177.2
Asia Pacific (“APAC”)	114.0	94.9
Total revenue	\$ 576.9	\$ 472.6

FORTINET, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Property and Equipment—net	March 31, 2020	December 31, 2019
Americas:		
United States	\$ 227.4	\$ 197.4
Canada	120.2	120.5
Latin America	6.1	5.5
Total Americas	353.7	323.4
EMEA	14.5	15.2
APAC	6.0	5.7
Total property and equipment—net	\$ 374.2	\$ 344.3

The following distributors accounted for 10% or more of our revenue:

	Three Months Ended	
	March 31, 2020	March 31, 2019
Exclusive Networks Group	31%	30%
Ingram Micro	10%	11%

The following distributors accounted for 10% or more of net accounts receivable:

	March 31, 2020	December 31, 2019
Exclusive Networks Group	34%	36%
Ingram Micro	*	10%

* Represents less than 10%

16. SUBSEQUENT EVENT

Share repurchase

Subsequent to March 31, 2020 through the filing of this Quarterly Report on Form 10-Q, we repurchased 1.5 million shares of our common stock under the Repurchase Program, for an aggregate purchase price of \$146.1 million.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

In addition to historical information, this Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities and Exchange Act of 1934, as amended (the "Exchange Act"). These statements include, among other things, statements concerning our expectations regarding:

- the duration and impact of the COVID-19 pandemic;
- continued growth and market share gains;
- variability in sales in certain product categories from year to year and between quarters;
- expected impact of sales of certain products and services;
- the impact of macro-economic, geopolitical factors and other disruption on our manufacturing or sales, including the impact of the COVID-19 pandemic and other public health issues and natural disasters;
- the proportion of our revenue that consists of our product and service revenue, and the mix of billings between products and services, and the duration of service contracts;
- the impact of our product innovation strategy;
- the effects of government regulation, tariffs and other related policies;
- drivers of long-term growth and operating leverage, such as increased sales productivity, functionality and value in our standalone and bundled subscription service offerings;
- growing our sales to businesses, service providers and government organizations, our ability to execute these sales and of the complexity of selling to all segments (including the increased competition and unpredictability of timing associated with sales to larger enterprises), the impact of sales to these organizations on our long-term growth, expansion and operating results, and the effectiveness of our internal sales organization;
- our ability to hire properly qualified and effective sales, support and engineering employees;
- trends in revenue, cost of revenue and gross margin;
- trends in our operating expenses, including sales and marketing expense, research and development expense, general and administrative expense, and expectations regarding these expenses;
- risks and expectations related to acquisitions or sales of assets, including integration issues related to product plans and products, including the acquired technology;
- continued investments in research and development, and expectations that our research and development expense will increase in absolute dollars during 2020;
- continued investments in our sales resources and infrastructure and marketing strategy, and expectations that our sales and marketing expense will increase in absolute dollars during 2020;
- expectations that our general and administrative expense will increase in absolute dollars during 2020;
- expectations that proceeds from the exercise of stock options in future years will be adversely impacted by the increased mix of restricted stock units versus stock options granted;
- estimates of a range of 2020 spending on our headquarters expansion project;

- *expectations regarding uncertain tax benefits and our effective domestic and global tax rates, and the impact of the Tax Cuts and Jobs Act (the “2017 Tax Act”) and the Ninth Circuit’s Altera decision regarding stock-based compensation in cost sharing arrangements;*
- *expectations regarding spending related to real estate and other capital expenditures and to the impact on free cash flows;*
- *competition in our markets;*
- *statements regarding expected outcomes and liabilities in litigation;*
- *our intentions regarding share repurchases and the sufficiency of our existing cash, cash equivalents and investments to meet our cash needs for at least the next 12 months;*
- *other statements regarding our future operations, financial condition and prospects and business strategies; and*
- *adoption and impact of new accounting standards.*

These forward-looking statements are subject to certain risks and uncertainties that could cause our actual results to differ materially from those reflected in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this Quarterly Report on Form 10-Q and, in particular, the risks discussed under the heading “Risk Factors” in Part II, Item 1A of this Quarterly Report on Form 10-Q and those discussed in other documents we file with the Securities and Exchange Commission (the “SEC”). We undertake no obligation, and specifically disclaim any obligation, to revise or publicly release the results of any revision to these and any other forward-looking statements. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

Business Overview

Fortinet is a global leader in cybersecurity solutions provided to a wide variety of organizations, such as enterprises, communication service providers, government organizations and small businesses. Our cybersecurity solutions are designed to provide broad visibility and segmentation of the digital attack surface through our integrated Fortinet Security Fabric platform, which features automated protection, detection and response.

The focus areas of our business consist of:

- **Security-Driven Networking**—We derive a majority of product sales from our FortiGate network security appliances. Our FortiGate network security appliances include a broad set of built-in security and networking features and functionalities, including firewall, next-generation firewall, secure web gateway, secure sockets layer inspection, software-defined wide-area network (“SD-WAN”), intrusion prevention, data leak prevention, virtual private network (“VPN”), switch and wireless controller and wide area network edge. Our network security appliances are managed by our FortiOS network operating system, which provides the foundation for FortiGate security functions. We enhance the performance of our network security appliances from branch to data center by designing and implementing Security Processing Unit (“SPU”) technology within our appliances, enabling us to add security and network functionality with minimal impact to network throughput performance.
- **Infrastructure Security**—The Fortinet Security Fabric platform is a broad, automated and integrated security platform that extends beyond the network to cover other attack vectors. Other infrastructure solutions covered include Secure Access (Wi-Fi and switch) and teleworker and remote security solutions such as FortiAuthenticator, FortiClient and FortiToken.
- **Dynamic Cloud Security**—We help customers connect securely to and across their hybrid, public and private cloud environments by offering security through our virtual firewall and other software products. Our public and private cloud security solutions, including virtual appliances and hosted solutions, extend the core capabilities of the Fortinet Security Fabric platform to provide businesses with the same level of cybersecurity and threat intelligence in and across cloud environments that they receive on their physical networks, delivering security that follows their applications and data. Fortinet cloud security offerings are available across all major cloud providers, including

Amazon Web Services, Microsoft Azure, Google Cloud, Oracle Cloud, Alibaba Cloud and IBM Cloud. Our Cloud Security portfolio also includes securing applications, including email and web.

- **Endpoint Protection, Internet of Things (“IoT”) and Operational Technology (“OT”) Security**—We protect end-customers from advanced threats that target their devices and the data that reside on them through our advanced endpoint solutions that provide core endpoint protection, advanced threat protection, incident monitoring, and response. Additionally, the proliferation of IoT and the digitization of OT devices has generated new opportunities for us to grow our business. We offer network access control solutions that provide visibility, control and automated event responses in order to secure IoT devices.
- **AI-Driven Security Operations**—We develop and provide AI-driven security operations solutions, including FortiGuard security services, that can be applied across the entire Fortinet Security Fabric platform. These solutions help customers better secure their environments by delivering deeper intelligence and insights and by narrowing the gaps in security skills and resources that are present in many organizations.

In addition to our security solutions, our customers may purchase FortiGuard and other security subscription services to receive threat intelligence updates, FortiCare technical support services and the support of Technical Account Managers, Resident Engineers and professional service consultants for implementations or training services.

Financial Highlights

- Total revenue was \$576.9 million during the three months ended March 31, 2020, an increase of 22% compared to \$472.6 million in the same period last year. Product revenue was \$192.3 million during the three months ended March 31, 2020, an increase of 18% compared to \$162.7 million in the same period last year. Service revenue was \$384.6 million during the three months ended March 31, 2020, an increase of 24% compared to \$309.9 million in the same period last year.
- We generated operating income of \$115.9 million, which included a gain on an intellectual property (“IP”) matter of \$36.8 million, during the three months ended March 31, 2020, an increase of 129% compared to \$50.6 million in the same period last year.
- Cash, cash equivalents and investments were \$1.57 billion as of March 31, 2020, a decrease of \$636.6 million, or 29%, from December 31, 2019.
- During the three months ended March 31, 2020, we repurchased 10.0 million shares of common stock under our Share Repurchase Program (the “Repurchase Program”), for a total purchase price of \$899.9 million.
- Deferred revenue was \$2.23 billion as of March 31, 2020, an increase of \$90.9 million, or 4%, from December 31, 2019.
- We generated cash flows from operating activities of \$319.4 million, which includes \$50 million proceeds from an IP matter, during the three months ended March 31, 2020, an increase of \$118.1 million, or 59%, compared to the same period last year.

Our revenue growth was driven by both product and service revenue. On a geographic basis, revenue continues to be diversified globally, which remains a key strength of our business. Americas, Europe, Middle East and Africa (“EMEA”) and Asia Pacific (“APAC”) comprised 42%, 38% and 20% of the total revenue, respectively, in the three months ended March 31, 2020 and 2019. Product revenue grew 18% during the three months ended March 31, 2020 compared to the same period last year. We experienced revenue growth across several of our hardware and software products, including SD-WAN and teleworker and remote security solutions. Service revenue growth of 24% during the three months ended March 31, 2020 compared to the same period last year was driven by the strength of our FortiGuard and other security subscription revenue, which grew 25% compared to the same period last year. During the three months ended March 31, 2020, FortiCare technical support and other service revenue grew 23% compared to the same period last year.

During the three months ended March 31, 2020, we recognized a \$36.8 million gain on an IP matter in connection with a mutual covenant-not-to-sue and release agreement with a competitor in the network security industry. Excluding the gain on the IP matter, operating expenses as a percentage of revenue decreased by one percentage point compared to the same period last year. Headcount increased to 7,448 employees and contractors as of March 31, 2020, a 5% growth compared to 7,082 as of December 31, 2019 and a 24% growth compared to 6,015 as of March 31, 2019.

COVID-19 Update

The United States and the global community we serve are facing unprecedented challenges posed by the COVID-19 pandemic. In response to the pandemic, we have taken a number of actions to protect our employees, including restricting travel and directing most of our employees to work from home. We have implemented our readiness plans, which include steps to maintain critical internet infrastructure with most employees working remotely. We have not conducted any employee layoffs related to the COVID-19 pandemic, and we do not anticipate any related layoffs for the foreseeable future. We have also increased our employee charitable contributions matching program for COVID-19 related donations and will match up to \$2.0 million of employee charitable contributions. In order to help address the needs of organizations securing highly distributed and remote workforces, we have opened our online, self-paced catalogue of advanced Network Security Expert training courses for free to the public. Costs incurred to date relating to COVID-19 impact mitigation efforts have not been material.

While we believe the pandemic has had certain impacts on our business, we do not believe there has been a material impact from the effects of the pandemic on our business and operations, results of operations, financial condition, cash flows, liquidity and capital and financial resources as of and during the three months ended March 31, 2020. While our linearity during the first quarter of 2020 was consistent with prior quarters, we saw an elevated level of buying during the middle two weeks of March. Our average service contract term remained consistent with the same period of 2019. Average customer payment terms increased by less than 15%. With respect to our supply chain, our product backlog was in line with historical averages and our suppliers delivered over 90% of their commitments to us. Our channel inventory levels were consistent with prior quarters.

Through the filing of this Quarterly Report on Form 10-Q, there have been no material changes to the trends described above. Going forward, however, the situation is uncertain, rapidly changing and hard to predict, and the COVID-19 pandemic may have a material negative impact on our future periods, including our results for the three months ending June 30, 2020, our annual results for 2020, and beyond. To highlight the uncertainty remaining for the three months ending June 30, 2020, it should be noted that, due to customer buying patterns and the efforts of our sales force and channel partners to meet or exceed quarterly quotas, we have historically received a substantial portion of each quarter's sales orders and generated a substantial portion of each quarter's billings and revenue during the last two weeks of the quarter. If we experience significant changes in our billings growth rates, it will impact current quarter product revenue and future quarters of our FortiGuard and FortiCare service revenues, as we sell annual and multi-year service contracts that are recognized ratably over the service term. In addition, the broader implications of the pandemic on our business and operations and our financial results, including the extent to which the effects of the pandemic will impact future results and growth in the cybersecurity industry, remain uncertain. The duration and severity of the economic downturn from the pandemic may negatively impact our business and operations, results of operations, financial condition, cash flows, liquidity and capital and financial resources in a material way. As a result, the effects of the pandemic may not be fully reflected in our results of operations until future periods. For further discussion, see Part II, Item 1A of this Quarterly Report on Form 10-Q.

Business Model

We primarily sell our products and services through a two-tier distribution model. We sell to distributors that sell to networking security and enterprise-focused resellers and to service providers and managed security service providers ("MSSPs"), who, in turn, sell to our end-customers. In certain cases, we sell directly to large service providers and major systems integrators. We also offer our products through major cloud providers, and have recognized on-demand revenue from Amazon Web Services, Microsoft Azure, IBM Cloud, Google Cloud and Oracle Cloud. We have also recognized revenue from customers who deploy our products in a bring-your-own-license ("BYOL") arrangement in private clouds or at cloud providers such as Amazon Web Services, Microsoft Azure, Google Cloud, Oracle Cloud and Alibaba Cloud. In a BYOL arrangement, a customer purchases a software license from us through our channel partners and deploys the software in a cloud provider's environment. Similarly, customers may purchase such a license from us and deploy in their private cloud.

Our customers purchase our hardware products and software licenses, as well as our FortiGuard security subscription and FortiCare technical support services. We generally invoice at the time of our sale for the total price of the products and security and technical support services. The invoice is typically payable within 30 to 60 days. We also invoice certain services on a monthly basis.

Key Metrics

We monitor a number of key metrics, including the key financial metrics set forth below, in order to help us evaluate growth trends, establish budgets, measure the effectiveness of our sales and marketing efforts, and assess operational

efficiencies. The following table summarizes revenue, deferred revenue, billings (non-GAAP), net cash provided by operating activities, and free cash flow (non-GAAP). We discuss revenue below under “Results of Operations,” and we discuss net cash provided by operating activities below under “—Liquidity and Capital Resources.” Deferred revenue, billings (non-GAAP), and free cash flow (non-GAAP) are discussed immediately below the following table:

	Three Months Ended Or As Of	
	March 31, 2020	March 31, 2019
	(in millions)	
Revenue	\$ 576.9	\$ 472.6
Deferred revenue	\$ 2,226.8	\$ 1,765.8
Billings (non-GAAP)	\$ 667.8	\$ 551.6
Net cash provided by operating activities	\$ 319.4	\$ 201.3
Free cash flow (non-GAAP)	\$ 241.8	\$ 191.1

Deferred revenue. Our deferred revenue consists of amounts that have been invoiced but that have not yet been recognized as revenue. The majority of our deferred revenue balance consists of the unrecognized portion of service revenue from FortiGuard security subscription and FortiCare technical support service contracts, which is recognized as revenue ratably over the contractual service period. We monitor our deferred revenue balance, deferred revenue growth and the mix of short-term and long-term deferred revenue because deferred revenue represents a significant portion of free cash flow and of revenue to be recognized in future periods. Deferred revenue was \$2.23 billion as of March 31, 2020, an increase of \$90.9 million, or 4%, from December 31, 2019.

Billings (non-GAAP). We define billings as revenue recognized in accordance with GAAP plus the change in deferred revenue from the beginning to the end of the period, less any deferred revenue balances acquired from business combination(s) during the period. We consider billings to be a useful metric for management and investors because billings drive current and future revenue, which is an important indicator of the health and viability of our business. There are a number of limitations related to the use of billings instead of GAAP revenue. First, billings include amounts that have not yet been recognized as revenue and are impacted by the term of security and support agreements. Second, we may calculate billings in a manner that is different from peer companies that report similar financial measures. Management accounts for these limitations by providing specific information regarding GAAP revenue and evaluating billings together with GAAP revenue. Total billings were \$667.8 million for the three months ended March 31, 2020, an increase of 21% compared to \$551.6 million in the same period last year.

A reconciliation of revenue, the most directly comparable financial measure calculated and presented in accordance with GAAP, to billings is provided below:

	Three Months Ended	
	March 31, 2020	March 31, 2019
	(in millions)	
Billings:		
Revenue	\$ 576.9	\$ 472.6
Add: Change in deferred revenue	90.9	79.0
Total billings (non-GAAP)	\$ 667.8	\$ 551.6

Free cash flow (non-GAAP). We define free cash flow as net cash provided by operating activities minus purchases of property and equipment and excluding any significant non-recurring items, such as proceeds from IP matter. We believe free cash flow to be a liquidity measure that provides useful information to management and investors about the amount of cash generated by the business that, after capital expenditures and net of proceeds from IP matter, can be used for strategic opportunities, including repurchasing outstanding common stock, investing in our business, making strategic acquisitions and strengthening the balance sheet. A limitation of using free cash flow rather than the GAAP measures of cash provided by or used in operating activities, investing activities, and financing activities is that free cash flow does not represent the total increase or decrease in the cash and cash equivalents balance for the period because it excludes proceeds from IP matter, cash flows from investing activities other than capital expenditures and cash flows from financing activities. Management accounts

for this limitation by providing information about our proceeds from IP matter, our capital expenditures and other investing and financing activities on the face of the consolidated statements of cash flows and under “—Liquidity and Capital Resources” and by presenting cash flows from investing and financing activities in our reconciliation of free cash flow. In addition, it is important to note that other companies, including companies in our industry, may not use free cash flow, may calculate free cash flow in a different manner than we do or may use other financial measures to evaluate their performance, all of which could reduce the usefulness of free cash flow as a comparative measure. A reconciliation of net cash provided by operating activities, the most directly comparable financial measure calculated and presented in accordance with GAAP, to free cash flow is provided below:

	Three Months Ended	
	March 31, 2020	March 31, 2019
	(in millions)	
Free Cash Flow:		
Net cash provided by operating activities	\$ 319.4	\$ 201.3
Less: Purchases of property and equipment	(27.6)	(10.2)
Less: Proceeds from IP matter	(50.0)	—
Free cash flow (non-GAAP)	\$ 241.8	\$ 191.1
Net cash provided by (used in) investing activities	\$ 4.6	\$ (39.0)
Net cash used in financing activities	\$ (920.4)	\$ (57.8)

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with GAAP. These principles require us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue, cost of revenue and expenses, and related disclosures. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. To the extent that there are material differences between these estimates and our actual results, our future financial statements will be affected.

There were no material changes to our critical accounting policies and estimates as of and for the three months ended March 31, 2020, as compared to the critical accounting policies and estimates described in our Annual Report on Form 10-K filed with the SEC on February 26, 2020 (the “Form 10-K”).

Recent Accounting Pronouncements

See Note 1 of the notes to condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for information regarding recent accounting pronouncements.

Results of Operations

Three Months Ended March 31, 2020 and March 31, 2019

Revenue

	Three Months Ended				Change	% Change
	March 31, 2020		March 31, 2019			
	Amount	% of Revenue	Amount	% of Revenue		
(in millions, except percentages)						
Revenue:						
Product	\$ 192.3	33%	\$ 162.7	34%	\$ 29.6	18%
Service	384.6	67	309.9	66	74.7	24
Total revenue	\$ 576.9	100%	\$ 472.6	100%	\$ 104.3	22%
Revenue by geography:						
Americas	\$ 242.2	42%	\$ 200.5	42%	\$ 41.7	21%
Europe, Middle East and Africa (“EMEA”)	220.7	38	177.2	38	43.5	25
Asia Pacific (“APAC”)	114.0	20	94.9	20	19.1	20
Total revenue	\$ 576.9	100%	\$ 472.6	100%	\$ 104.3	22%

Total revenue increased by \$104.3 million, or 22%, during the three months ended March 31, 2020 compared to the same period last year. We continued to experience diversification of revenue globally and across both customer and industry segments. Revenue from all regions grew, with EMEA contributing the largest portion of our revenue growth on a percentage basis and on an absolute dollar basis.

Product revenue increased by \$29.6 million, or 18%, during the three months ended March 31, 2020 compared to the same period last year. We experienced revenue growth across many of our hardware and software products due to an increase in product revenue from our FortiGate solutions, including SD-WAN, growth in sales of our Infrastructure Security solutions and teleworker and remote security solutions.

Service revenue increased by \$74.7 million, or 24%, during the three months ended March 31, 2020 compared to the same period last year. FortiGuard security subscription and FortiCare technical support and other revenues increased by \$41.8 million, or 25%, and by \$32.9 million, or 23%, respectively, during the three months ended March 31, 2020 compared to the same period last year. The increases were primarily due to the recognition of revenue from our growing deferred revenue balance related to FortiGuard and other security subscriptions and FortiCare technical support, including our customers moving to higher-tier support offerings. Of the service revenue recognized during the three months ended March 31, 2020, 91% was included in the deferred revenue balance as of December 31, 2019.

Cost of revenue and gross margin

	Three Months Ended				Change	% Change	
	March 31, 2020		March 31, 2019				
(in millions, except percentages)							
Cost of revenue:							
Product	\$	76.3	\$	70.2	\$	6.1	9%
Service		52.4		42.8		9.6	22
Total cost of revenue	\$	128.7	\$	113.0	\$	15.7	14%
Gross margin (%):							
Product		60.3%		56.9%			
Service		86.4		86.2			
Total gross margin		77.7%		76.1%			

Total gross margin increased by 1.6 percentage points during the three months ended March 31, 2020 compared to the same period last year, driven by improvements to both product and service gross margins.

Product gross margin increased by 3.4 percentage points during the three months ended March 31, 2020 compared to the same period last year. Product gross margin benefited from increased software sales and lower indirect costs of hardware as a percentage of product revenue. Cost of product revenue was comprised primarily of third party contract manufacturers' costs and the costs of materials used in production.

Service gross margin increased by 0.2 percentage points during the three months ended March 31, 2020 compared to the same period last year, as our service revenue growth outpaced our growth in related personnel costs. Cost of service revenue was comprised primarily of personnel costs.

Operating expenses

	Three Months Ended								
	March 31, 2020		March 31, 2019		Change	% Change			
	Amount	% of Revenue	Amount	% of Revenue					
(in millions, except percentages)									
Operating expenses:									
Research and development	\$	80.3	14%	\$	68.6	14%	\$	11.7	17%
Sales and marketing		260.0	45		215.9	46		44.1	20
General and administrative		28.8	5		24.5	5		4.3	18
Gain on IP matter		(36.8)	(6)		—	—		(36.8)	*
Total operating expenses	\$	332.3	58%	\$	309.0	65%	\$	23.3	8%

Percentages have been rounded for presentation purposes and may differ from unrounded results.

* Not meaningful

Research and development

Research and development expense increased by \$11.7 million, or 17%, during the three months ended March 31, 2020 compared to the same period last year, primarily due to an increase of \$11.6 million in personnel-related costs as a result of increased headcount to support the development of new products, continued enhancements to our existing products and patent creation. We currently intend to continue to invest in our research and development organization, and expect research and development expense to remain at or increase in absolute dollars during the remainder of 2020.

Sales and marketing

Sales and marketing expense increased by \$44.1 million, or 20%, during the three months ended March 31, 2020 compared to the same period last year, primarily due to an increase of \$37.9 million in personnel-related costs as a result of increases to sales and marketing headcount in order to drive global market share gains. This increase was offset by savings related to decreased travel in the first quarter of 2020 as a response to the COVID-19 pandemic. We currently intend to continue to make investments in our sales resources and infrastructure and marketing strategy, which are critical to support our future growth, and expect sales and marketing expense to remain at or increase in absolute dollars during the remainder of 2020.

General and administrative

General and administrative expense increased by \$4.3 million, or 18%, during the three months ended March 31, 2020 compared to the same period last year, primarily due to an increase in personnel-related costs of \$2.4 million and an increase in professional services costs of \$1.2 million. We currently expect general and administrative expense to remain at or increase in absolute dollars during the remainder of 2020.

Gain on IP matter

In January 2020, we entered into an agreement with a competitor in the network security industry, whereby, in February 2020, the competitor party paid us a lump sum of \$50.0 million for a seven-year mutual covenant-not-to-sue for patent claims. Pursuant to this agreement, at the end of this first seven-year period, either party may extend the agreement for an additional seven-year mutual covenant-not-to-sue in return for this competitor paying us an additional \$50.0 million. We determined the agreement to be a 14-year contract with a total transaction price of \$100.0 million. During the three months ended March 31, 2020, we recorded \$36.0 million upfront and an additional \$0.8 million in amortization of the deferred component as a gain on IP matter in our condensed consolidated statements of income. See Note 10 of the notes to condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for additional information regarding the gain on IP matter.

Operating income and margin

We generated operating income of \$115.9 million during the three months ended March 31, 2020, an increase of \$65.3 million, or 129%, compared to \$50.6 million in the same period last year. Operating income as a percentage of revenue increased to 20% during the three months ended March 31, 2020 compared to 11% in the same period last year. The increase in operating margin is primarily due to the \$36.8 million gain on IP matter, combined with the improvement in gross margin of 1.6 percentage points.

Interest income—net and other expense—net

	Three Months Ended		Change	% Change
	March 31, 2020	March 31, 2019		
	(in millions, except percentages)			
Interest income—net	\$ 9.2	\$ 10.2	\$ (1.0)	(10)%
Other expense—net	\$ (8.0)	\$ (0.5)	\$ (7.5)	1,500 %

Interest income—net decreased during the three months ended March 31, 2020 compared to the same period last year, primarily due to lower interest rates and, to a lesser extent, lower invested balances of cash, cash equivalents and investments. The lower cash, cash equivalents and investments were mainly due to our \$889.9 million payment for repurchase and retirement of common stock under the Repurchase Program in the three months ended March 31, 2020. Interest income—net varies depending on our average investment balances during the period, types and mix of investments, and market interest rates. The change in other expense—net during the three months ended March 31, 2020 compared to the same period last year was the result of a \$4.3 million impairment charge on an investment in a privately held company during the first quarter of 2020. In addition, foreign currency exchange losses increased by \$3.1 million compared to the same period last year.

Provision for income taxes

	Three Months Ended			
	March 31, 2020	March 31, 2019	Change	% Change
	(in millions, except percentages)			
Provision for income taxes	\$ 13.1	\$ 1.5	\$ 11.6	773%
Effective tax rate (%)	11%	2%		

Our effective tax rate was 11% for the three months ended March 31, 2020 compared to an effective tax rate of 2% for the same period last year. The provision for income taxes for the three months ended March 31, 2020 was primarily comprised of U.S. federal and state taxes, withholding taxes and foreign taxes that were \$28.3 million, which included a tax benefit of \$4.8 million from the foreign-derived intangible income deduction. This tax provision for income taxes was further offset by excess tax benefits from stock-based compensation expense of \$15.2 million. The provision for income taxes for the three months ended March 31, 2019 was comprised of U.S. federal and state taxes, withholding taxes, and foreign taxes that were \$17.5 million, which were offset by excess tax benefits from stock-based compensation expense of \$16.0 million.

Liquidity and Capital Resources

	As of	
	March 31, 2020	December 31, 2019
	(in millions)	
Cash and cash equivalents	\$ 626.1	\$ 1,222.5
Investments	947.2	987.4
Total cash, cash equivalents and investments	\$ 1,573.3	\$ 2,209.9
Working capital	\$ 492.3	\$ 1,295.4

	Three Months Ended	
	March 31, 2020	March 31, 2019
	(in millions)	
Net cash provided by operating activities	\$ 319.4	\$ 201.3
Net cash provided by (used in) investing activities	4.6	(39.0)
Net cash used in financing activities	(920.4)	(57.8)
Net increase in cash and cash equivalents	\$ (596.4)	\$ 104.5

Liquidity and capital resources may be impacted by our operating activities, as well as by our stock repurchases, proceeds associated with stock option exercises, issuances of common stock under our the Amended and Restated Fortinet, Inc. 2009 Equity Incentive Plan (the "Amended Plan") and payment of taxes in connection with the net settlement of equity awards, real estate and other capital expenditures and business acquisitions. During the three months ended March 31, 2020, we repurchased \$899.9 million in shares of our common stock under the Repurchase Program. In February 2020, we received a cash payment of \$50.0 million pursuant to a mutual covenant-not-to-sue and release agreement with a competitor in the network security industry.

In recent years, we have received significant capital resources from our billings to customers and, to some extent, from exercise of stock options. Additional increases in billings may depend on a number of factors, including demand for our products and services, competition, market or industry changes, macroeconomic events such as the COVID-19 pandemic and our ability to execute. We expect proceeds from the exercise of stock options in future years to be impacted by the increased mix of restricted stock units versus stock options granted and also to vary based on our share price. As of March 31, 2020, \$692.9 million remained available for future share repurchases under the Repurchase Program.

Construction of a second building at our headquarters campus started in the fourth quarter of 2018 and related spending will continue in 2020 and until project completion. We estimate 2020 spending on the headquarters campus project to

be between \$110.0 million and \$120.0 million dollars. The COVID-19 pandemic has resulted in a delay to the project schedule. We now estimate construction to be completed in early 2021.

As of March 31, 2020, our cash, cash equivalents and investments of \$1.57 billion were invested primarily in deposit accounts, money market funds, corporate debt securities, commercial paper, certificates of deposit and term deposits and U.S. government securities. It is our investment policy to invest excess cash in a manner that preserves capital, provides liquidity and generates return without significantly increasing risk. We do not enter into investments for trading or speculative purposes.

The amount of cash, cash equivalents and investments held by our international subsidiaries was \$116.8 million as of March 31, 2020 and \$109.3 million as of December 31, 2019.

We believe that our existing cash and cash equivalents will be sufficient to meet our anticipated cash needs for at least the next 12 months. Our future capital requirements will depend on many factors, including our growth rate, the timing and amount of our share repurchases, the timing and extent of spending to support development efforts, the expansion of sales and marketing activities, the introduction of new and enhanced products and services offerings, the continuing market acceptance of our products, our investments in purchasing or leasing real estate and macroeconomic impacts such as the COVID-19 pandemic. Historically, we have required capital principally to fund our working capital needs, share repurchases, capital expenditures and acquisition activities. In the event that additional financing is required from outside sources, we may not be able to raise it on terms acceptable to us or at all.

Operating Activities

Cash generated by operating activities is our primary source of liquidity. It is primarily comprised of net income, as adjusted for non-cash items and changes in operating assets and liabilities. Non-cash adjustments consist primarily of stock-based compensation, amortization of deferred contract costs and depreciation and amortization. Changes in operating assets and liabilities consist primarily of changes in deferred revenue, deferred contract costs, accounts receivable, inventory and prepaid expenses and other current assets.

Our operating activities during the three months ended March 31, 2020 provided \$319.4 million in cash as a result of the continued growth of our business and our ability to successfully manage our working capital. Changes in operating assets and liabilities primarily resulted from an increase in sales of our FortiGuard security subscription and FortiCare technical support services to new and existing customers, as reflected by an increase in our deferred revenue, and proceeds from the mutual covenant-not-to-sue and release agreement. Our total deferred revenue balance grew \$90.9 million, or 4%, during the three months ended March 31, 2020.

Investing Activities

The changes in cash flows from investing activities primarily relate to timing of purchases, maturities and sales of investments and purchases of property and equipment. Historically, in making a lease versus ownership decision related to our larger facilities, we have considered various factors including financial metrics and the impact on our engineers and other employees. In certain cases, we have elected to own a facility if we believed that ownership rather than leasing is more in line with our long-term strategy. We expect to make similar decisions in the future. We may also make cash payments in connection with future business combinations.

During the three months ended March 31, 2020, cash provided by investing activities was \$4.6 million, primarily driven by \$35.7 million in cash proceeds from maturities and sales of investments, net of purchases of investments, and partially offset by \$27.6 million of purchases of property and equipment, a large portion of which relates to our headquarters building construction.

Financing Activities

The changes in cash flows from financing activities primarily relate to repurchase and retirement of common stock and taxes paid related to net share settlement of equity awards, net of proceeds from the issuance of common stock under the Amended Plan.

During the three months ended March 31, 2020, cash used in financing activities was \$920.4 million, primarily driven by \$889.9 million used to repurchase shares of our common stock and \$30.4 million used to pay tax withholding, net of proceeds from the issuance of common stock.

Contractual Obligations and Commitments

There were no material changes outside the ordinary course of business during the three months ended March 31, 2020 to the contractual obligations and commitments disclosed in Management's Discussion and Analysis of Financial Condition and Results of Operations, set forth in Part II, Item 7, of the Form 10-K. See Note 11 of the notes to condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for additional information regarding contractual obligations and commitments.

Off-Balance Sheet Arrangements

As of March 31, 2020, we did not have any relationships with unconsolidated organizations or financial partnerships, such as structured finance or special purpose entities that would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

There were no material changes in our market risk during the three months ended March 31, 2020 compared to the disclosures in Part II, Item 7A of the Form 10-K.

ITEM 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(e) under the Exchange Act as of March 31, 2020. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

Based on that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective as of March 31, 2020 to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) or 15d-15(f) under the Exchange Act) during the three months ended March 31, 2020 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II—OTHER INFORMATION

ITEM 1. Legal Proceedings

We are subject to various claims, complaints and legal actions that arise from time to time in the normal course of business. We accrue for contingencies when we believe that a loss is probable and that we can reasonably estimate the amount of any such loss. There can be no assurance that existing or future legal proceedings arising in the ordinary course of business or otherwise will not have a material adverse effect on our business, consolidated financial position, results of operations or cash flows.

ITEM 1A. Risk Factors

Investing in our common stock involves a high degree of risk. Investors should carefully consider the following risks and all other information contained in this Quarterly Report on Form 10-Q, including our consolidated financial statements and the related notes, before investing in our common stock. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties that we are unaware of, or that we currently believe are not material, also may become important factors that affect us. If any of the following risks materialize, our business, financial condition and results of operations could be materially harmed. In that case, the trading price of our common stock could decline substantially, and investors may lose some or all of their investment.

Risks Related to Our Business

Our operating results are likely to vary significantly and be unpredictable.

Our operating results have historically varied from period to period, and we expect that they will continue to do so as a result of a number of factors, many of which are outside of our control or may be difficult to predict, including:

- our ability to attract and retain new end-customers or sell additional products and services to our existing end-customers;
- the level of demand for our products and services, which may render forecasts inaccurate;
- the timing of channel partner and end-customer orders, and our reliance on a concentration of shipments at the end of each quarter;
- the impact to our business, the global economy, disruption of global supply chains and creation of significant volatility and disruption of the financial markets due to the COVID-19 pandemic;
- the timing of shipments, which may depend on factors such as inventory levels, logistics, manufacturing or shipping delays, our ability to ship new products on schedule and our ability to accurately forecast inventory requirements;
- inventory management;
- component and product inventory shortages, including those caused by factors outside of our control such as natural disasters and health emergencies, including earthquakes, fires, power outages, typhoons, floods, pandemics or epidemics such as the COVID-19 pandemic and manmade events such as civil unrest, labor disruption, international trade disputes, international conflicts, terrorism, wars and critical infrastructure attacks;
- the mix of products sold and the mix of revenue between products and services, as well as the degree to which products and services are bundled and sold together for a package price;
- the purchasing practices and budgeting cycles of our channel partners and end-customers, including the effect of the end of product refresh cycles;
- any decreases in demand by channel partners or end-customers, including any such decreases caused by factors outside of our control such as natural disasters and health emergencies, including earthquakes, fires, power outages, typhoons, floods, pandemics or epidemics such as the COVID-19 pandemic and manmade

events such as civil unrest, labor disruption, international trade disputes, international conflicts, terrorism, wars and critical infrastructure attacks;

- the effectiveness of our sales organization, generally or in a particular geographic region, the time it takes to hire sales personnel and the timing of hiring, and our ability to hire and retain effective sales personnel;
- sales execution risk related to effectively selling to all segments of the market, including enterprise and small- and medium-sized businesses and service providers, and to selling our broad security product and services portfolio, including, among other execution risks, risks associated with the complexity and distraction in selling to all segments and increased competition and unpredictability of timing to close sales deals with large enterprises;
- execution risk associated with our efforts to capture the opportunities related to our identified growth drivers, such as risk associated with our ability to capitalize on network security and software defined wide area network (“SD-WAN”), infrastructure security, cloud security and endpoint protection, IoT and OT security opportunities;
- the seasonal buying patterns of our end-customers;
- the timing and level of our investments in sales and marketing, and the impact of such investments on our operating expenses, operating margin and the productivity and effectiveness of execution of our sales and marketing teams;
- the timing of revenue recognition for our sales;
- the level of perceived threats to network security, which may fluctuate from period to period;
- any actual or perceived vulnerabilities in our products or services, and any actual or perceived breach of our network or our customers’ networks;
- changes in the requirements, market needs or buying practices and patterns of our distributors, resellers or end-customers;
- changes in the growth rates of the network security market in particular and other security and networking markets, such as SD-WAN, for which we sell products and services;
- the timing and success of new product and service introductions or enhancements by us or our competitors, or any other change in the competitive landscape of our industry, including consolidation among our competitors, partners or end-customers;
- the deferral of orders from distributors, resellers or end-customers in anticipation of new products or product enhancements announced by us or our competitors;
- increases or decreases in our billings, revenue and expenses caused by fluctuations in foreign currency exchange rates or a strengthening of the U.S. dollar, as a significant portion of our expenses is incurred and paid in currencies other than the U.S. dollar, and the impact such fluctuations may have on the actual prices that our partners and customers are willing to pay for our products and services;
- compliance with existing laws and regulations that are applicable to our ability to conduct business with the public sector and other sectors;
- litigation, litigation fees and costs, settlements, judgments and other equitable and legal relief granted related to litigation;
- the impact of cloud-based platforms on our billings, revenues, operating margins and free cash flow;
- decisions by potential end-customers to purchase network security solutions from newer technology providers, from larger, more established security vendors or from their primary network equipment vendors;

- price competition and increased competitiveness in our market, including the competitive pressure caused by product refresh cycles;
- our ability to both increase revenues and manage and control operating expenses in order to improve our operating margins;
- changes in customer renewal rates or attached rates for our services;
- changes in the payment terms of services contracts or the contractual term of services contracts sold;
- changes in payment terms of our contracts with service providers and distributors;
- changes in our estimated annual effective tax rates;
- changes in circumstances and challenges in business conditions, including decreased demand, which may negatively impact our channel partners' ability to sell the current inventory they hold and negatively impact their future purchases of products from us;
- increased demand for cloud-based services and the uncertainty associated with transitioning to providing such services;
- increased expenses, unforeseen liabilities or write-downs and any impact on results of operations from any acquisition consummated;
- our channel partners having insufficient financial resources to withstand changes and challenges in business conditions;
- disruptions in our channel or termination of our relationship with important channel partners, including as a result of consolidation among distributors and resellers of security solutions;
- insolvency, credit or other difficulties confronting our key suppliers and channel partners, which could affect their ability to purchase or pay for products and services and which could disrupt our supply or distribution chain;
- policy changes and uncertainty with respect to immigration laws, trade policy and tariffs, including increased tariffs applicable to countries where we manufacture our products, foreign imports and tax laws related to international commerce;
- political, economic and social instability, including geo-political instability and uncertainty, such as the impact of the United Kingdom's exit from the European Union ("Brexit");
- general economic conditions, both in domestic and foreign markets;
- future accounting pronouncements or changes in our accounting policies as well as the significant costs that may be incurred to adopt and comply with these new pronouncements;
- possible impairments or acceleration of depreciation of our existing real estate due to our current real estate holdings and future development plans; and
- legislative or regulatory changes, such as with respect to privacy, information and cybersecurity, exports, the environment and applicable accounting standards.

Any one of the factors above or the cumulative effect of some of the factors referred to above may result in significant fluctuations in our quarterly financial and other operating results. This variability and unpredictability could result in our failing to meet our internal operating plan or the expectations of securities analysts or investors for any period. If we fail to meet or exceed such expectations for these or any other reasons, the market price of our shares could fall substantially and we could face costly lawsuits, including securities class action suits. In addition, a significant percentage of our operating expenses are fixed in nature over the near term. Accordingly, in the event of revenue shortfalls, we are generally unable to mitigate the negative impact on margins in the short term.

The outbreak and spread of the COVID-19 pandemic could adversely affect our business in a material way.

The COVID-19 pandemic has negatively impacted the global economy, disrupted global supply chains and demand for certain solutions and created significant volatility in, and disruption of, global financial markets. The extent of the impact of the COVID-19 pandemic on our operational and financial performance, including our ability to execute our business strategies and initiatives in the expected time frame, will depend on future developments, including the duration and spread of the pandemic and related restrictions on, and disruptions of, business and world economies, all of which are uncertain and cannot be predicted. An extended period of global supply chain disruption, demand reduction and economic slowdown could materially negatively affect our overall business and our operating results, including billings, revenue, gross margins, operating margins, cash flows and other operating results. If the spread of the COVID-19 pandemic limits the availability of our products, either by limiting components available, by limiting the actual manufacture and assembly or by limiting or restricting shipping of components and products, this likely would result in increased product backlog, lower billings, lower revenue and decreased profitability and would negatively impact, and may materially negatively impact, our operating results and business. Moreover, the COVID-19 pandemic has created a reduction in certain business activity and demand for certain solutions, which may negatively affect the rate and amount of our billings, also possibly in a materially negative way. The COVID-19 pandemic will adversely affect certain of our customers' ability or willingness to purchase our products and services, delay certain customers' purchasing decisions and increase customer attrition rates, all of which will adversely affect our future sales and operating results, possibly in a material way. As a result, we may experience extended sales cycles; our ability to close transactions with new and existing customers and partners may be negatively impacted; our ability to recognize revenue from sales we do close may be negatively impacted due to product or component shortages, implementation delays or other factors; and our ability to provide technical and other support to our customers may be affected. In addition, the COVID-19 pandemic has caused an increase in our expenses, including increased shipping costs, increased cancellation charges and reduced attendance fees due to the cancellation of a number of our 2020 Accelerate sales conferences, and it may result in increased component and product manufacturing costs. The full impact of the COVID-19 pandemic is unknown at this time. While we continue to monitor developments and the potential effect on our business, it is clear that the COVID-19 pandemic will negatively impact certain sales and may have a material negative impact on our operating results in the near term and longer term.

Adverse economic conditions or reduced information technology spending may adversely impact our business.

Our business depends on the overall demand for information technology and on the economic health of our current and prospective customers. In addition, the purchase of our products is often discretionary and may involve a significant commitment of capital and other resources. Weak global and regional economic conditions and spending environments, geopolitical instability and uncertainty, weak economic conditions in certain regions or a reduction in information technology spending regardless of macro-economic conditions, including the effects of the COVID-19 pandemic on the foregoing issues, could have adverse impacts on our business, financial condition and results of operations, including longer sales cycles, lower prices for our products and services, higher default rates among our channel partners, reduced unit sales and slower or declining growth.

Our billings, revenue, operating margin and free cash flow growth may slow or may not continue.

We may experience slowing growth, or a decrease, in billings, revenue, operating margin and free cash flow for a number of reasons, including as a result of the COVID-19 pandemic, a slowdown in demand for our products or services, a shift in demand from products to services, increased competition, a decrease in the growth of our overall market or softness in demand in certain geographies or industry verticals, such as the service provider industry, changes in our strategic opportunities, execution risks and our failure for any reason to continue to capitalize on sales and growth opportunities due to other risks identified in the risk factors described in this periodic report. Our expenses as a percentage of total revenue may be higher than expected if our revenue is lower than expected and, if our investments in sales and marketing and other functional areas do not result in expected billings and revenue growth, we may experience margin declines and may not be able to sustain profitability in future periods if we fail to increase billings, revenue or deferred revenue, do not appropriately manage our cost structure and free cash flow or encounter unanticipated liabilities. Any failure by us to maintain profitability, maintain our margins and continue our billings, revenue and free cash flow growth could cause the price of our common stock to materially decline.

We rely on third-party channel partners for substantially all of our revenue. If our partners fail to perform, our ability to sell our products and services will be limited, and if we fail to optimize our channel partner model going forward, our operating results may be harmed. Additionally, a small number of distributors represents a large percentage of our revenue and gross accounts receivable, and one distributor accounted for 34% of our total net accounts receivable as of March 31, 2020.

A significant portion of our sales is generated through a limited number of distributors, and substantially all of our revenue is from sales by our channel partners, including distributors and resellers. We depend on our channel partners to generate a significant portion of our sales opportunities and to manage our sales process. To the extent our channel partners are unsuccessful in selling our products, or if we are unable to enter into arrangements with and retain a sufficient number of high-quality channel partners in each of the regions in which we sell products, we are unable to keep them motivated to sell our products, or our channel partners shift focus to other vendors and/or our competitors, our ability to sell our products and operating results may be harmed. The termination of our relationship with any significant channel partner may adversely impact our sales and operating results.

In addition, a small number of channel partners represents a large percentage of our revenue and gross accounts receivable. We are exposed to the credit and liquidity risk of some of our channel partners and to credit exposure in weakened markets, which could result in material losses. Our dependence on a limited number of key channel partners means that our billings, revenue and operating results may be harmed by the inability of these key channel partners to successfully sell our products and services, or if any of these key channel partners is unable or unwilling to pay us, terminates its relationship with us or goes out of business. Although we have programs in place that are designed to monitor and mitigate credit and liquidity risks, we cannot guarantee these programs will be effective in reducing our credit risks. If we are unable to adequately control these risks, our business, operating results, and financial condition could be harmed. If channel partners fail to pay us under the terms of our agreements or we are otherwise unable to collect on our accounts receivable from these channel partners, we may be adversely affected both from the inability to collect amounts due and the cost of enforcing the terms of our contracts, including litigation. Our channel partners may seek bankruptcy protection or other similar relief and fail to pay amounts due to us, or pay those amounts more slowly, either of which could adversely affect our operating results, financial position, and cash flow. We may be further impacted by consolidation of our existing channel partners. In such instances, we may experience changes to our overall business and operational relationships due to dealing with a larger combined entity, and our ability to maintain such relationships on favorable contractual terms may be more limited. We may also become increasingly dependent on a more limited number of channel partners, as consolidation increases the relative proportion of our business for which each channel partner is responsible, which may magnify the risks described in the preceding paragraphs.

Exclusive accounted for 34% of our total net accounts receivable as of March 31, 2020. During the three months ended March 31, 2020, Exclusive and Ingram Micro, Inc. (“Ingram Micro”) accounted for 31% and 10% of our total revenue, respectively. Exclusive and Ingram Micro accounted for 34% and 10% of our total net accounts receivable as of March 31, 2019, respectively. During the three months ended March 31, 2019, Exclusive and Ingram Micro accounted for 30% and 11% of our total revenue, respectively. In addition to other risks associated with the concentration of accounts receivable and revenue from these distributors, Exclusive is a private entity and we may not have sufficient information to assess its financial condition and, accordingly, if Exclusive were to experience financial difficulties, we might not have advance notice. Additionally, Exclusive may face liquidity risk as a private equity-backed company, which may harm our ability to collect on our accounts receivable.

We provide sales channel partners with specific programs to assist them with selling our products and incentivize them to sell our products, but there can be no assurance that these programs will be effective. In addition, our channel partners may be unsuccessful in marketing, selling and supporting our products and services and may purchase more inventory than they can sell. Our channel partners generally do not have minimum purchase requirements. Some of our channel partners may have insufficient financial resources to withstand changes and challenges in business conditions. Moreover, many of our channel partners are privately held, including our largest distributor Exclusive Networks, and we may not have sufficient information to assess their financial condition. If our channel partners’ financial condition or operations weaken, their ability to sell our product and services could be negatively impacted. Our channel partners may also market, sell and support products and services that are competitive with ours, and may devote more resources to the marketing, sales and support of such products, or may decide to cease selling our products and services altogether in favor of a competitor’s products and services. They may also have incentives to promote our competitors’ products to the detriment of our own, or they may cease selling our products altogether. We cannot ensure that we will retain these channel partners or that we will be able to secure additional or replacement partners or that existing channel partners will continue to perform. The loss of one or more of our significant channel partners or the failure to obtain and ship a number of large orders each quarter through them could harm our operating results.

Any new sales channel partner will require extensive training and may take several months or more to achieve productivity. Our channel partner sales structure could subject us to lawsuits, potential liability and reputational harm if, for example, any of our channel partners misrepresent the functionality of our products or services to end-customers or our channel partners violate laws or our corporate policies. We depend on our global channel partners to comply with applicable legal and regulatory requirements. To the extent that they fail to do so, that could have a material adverse effect on our business, operating results and financial condition. If we fail to optimize our channel partner model or fail to manage existing sales channels, our business will be seriously harmed.

We rely significantly on revenue from FortiGuard security subscription and FortiCare technical support services, and revenue from these services may decline or fluctuate. Because we recognize revenue from these services over the term of the relevant service period, downturns or upturns in sales of FortiGuard security subscription and FortiCare technical support services are not immediately reflected in full in our operating results.

Our FortiGuard security subscription and FortiCare technical support services revenue has historically accounted for a significant percentage of our total revenue. Revenue from the sale of new, or from the renewal of existing, FortiGuard security subscription and FortiCare technical support service contracts may decline and fluctuate as a result of a number of factors, including fluctuations in purchases of FortiGate appliances or our Fortinet Security Fabric platform products, changes in the sales mix between products and services, end-customers' level of satisfaction with our products and services, the prices of our products and services, the prices of products and services offered by our competitors, reductions in our customers' spending levels and the timing of revenue recognition with respect to these arrangements. If our sales of new, or renewals of existing, FortiGuard security subscription and FortiCare technical support service contracts decline, our revenue and revenue growth may decline and our business could suffer. In addition, in the event significant customers require payment terms for FortiGuard security subscription and FortiCare technical support services in arrears or for shorter periods of time than annually, such as monthly or quarterly, this may negatively impact our billings and revenue. Furthermore, we recognize FortiGuard security subscription and FortiCare technical support services revenue monthly over the term of the relevant service period, which is typically from one to five years. As a result, much of the FortiGuard security subscription and FortiCare technical support services revenue we report each quarter is the recognition of deferred revenue from FortiGuard security subscription and FortiCare technical support services contracts entered into during previous quarters or years. Consequently, a decline in new or renewed FortiGuard security subscription and FortiCare technical support services contracts in any one quarter will not be fully reflected in revenue in that quarter but will negatively affect our revenue in future quarters. Accordingly, the effect of significant downturns in sales of new, or renewals of existing, FortiGuard security subscription and FortiCare technical support services is not reflected in full in our statements of income until future periods. Our FortiGuard security subscription and FortiCare technical support services revenue also makes it difficult for us to rapidly increase our revenue through additional service sales in any period, as revenue from new and renewal support services contracts must be recognized over the applicable service period.

We generate a majority of revenue from sales to distributors, resellers and end-customers outside of the United States, and we are therefore subject to a number of risks associated with international sales and operations.

We market and sell our products throughout the world and have established sales offices in many parts of the world. Our international sales have represented a majority of our total revenue in recent periods. Therefore, we are subject to risks associated with having worldwide operations. We are also subject to a number of risks typically associated with international sales and operations, including:

- economic or political instability in foreign markets;
- greater difficulty in enforcing contracts and accounts receivable collection, including longer collection periods;
- longer sales processes for larger deals, particularly during the summer months or as a result of the COVID-19 pandemic and related travel and gathering restrictions;
- changes in regulatory requirements;
- difficulties and costs of staffing and managing foreign operations;
- the uncertainty of protection for IP rights in some countries;

- costs of compliance with foreign policies, laws and regulations and the risks and costs of non-compliance with such policies, laws and regulations;
- any disruption in manufacturing or shipping or decreases in demand by channel partners or end-customers, including any such disruption or decreases caused by factors outside of our control such as natural disasters and health emergencies, including earthquakes, fires, power outages, typhoons, floods, pandemics or epidemics such as the COVID-19 pandemic and manmade events such as civil unrest, labor disruption, international trade disputes, international conflicts, terrorism, wars and critical infrastructure attacks;
- protectionist policies and penalties, and local laws, requirements, policies and perceptions that may adversely impact a U.S.-headquartered business's sales in certain countries outside of the United States;
- costs of complying with, and the risks, reputational damage and other costs of non-compliance with, U.S. or other foreign laws and regulations for foreign operations, including the U.S. Foreign Corrupt Practices Act, the United Kingdom Bribery Act 2010, the General Data Protection Regulation (the "GDPR"), import and export control laws, trade laws and regulations, tariffs and retaliatory measures, trade barriers and economic sanctions;
- other regulatory or contractual limitations on our ability to sell our products in certain foreign markets, and the risks and costs of non-compliance;
- heightened risks of unfair or corrupt business practices in certain geographies and of improper or fraudulent sales or sales-related arrangements, such as sales "side agreements" to allow return rights, that could disrupt the sales team through terminations of employment or otherwise, and may adversely impact financial results as compared to those already reported or forecasted and result in restatements of financial statements and irregularities in financial statements;
- our ability to effectively implement and maintain adequate internal controls to properly manage our international sales and operations;
- political unrest, changes and uncertainty associated with terrorism, hostilities, war or natural disasters;
- changes in foreign currency exchange rates;
- management communication and integration problems resulting from cultural differences and geographic dispersion; and
- changes in tax, tariff, employment and other laws.

The ongoing effects of the COVID-19 pandemic may enhance the severity and unpredictability of a number of the foregoing risks.

Product and service sales and employee and contractor matters may be subject to foreign governmental regulations, which vary substantially from country to country. Further, we may be unable to keep up to date with changes in government requirements as they change over time. Failure to comply with these regulations could result in adverse effects to our business. In many foreign countries, it is common for others to engage in business practices that are prohibited by our internal policies and procedures or U.S. regulations applicable to us. Although we implemented policies and procedures designed to ensure compliance with these laws and policies, there can be no assurance that all of our employees, contractors, channel partners and agents will comply with these laws and policies. Violations of laws or key control policies by our employees, contractors, channel partners or agents could result in litigation, regulatory action, costs of investigation, delays in revenue recognition, delays in financial reporting, financial reporting misstatements, fines, penalties or the prohibition of the importation or exportation of our products and services, any of which could have a material adverse effect on our business and results of operations.

We may undertake corporate operating restructurings or transfers of assets that involve our group of foreign country subsidiaries through which we do business abroad, in order to maximize the operational and tax efficiency of our group structure. If ineffectual, such restructurings or transfers could increase our income tax liabilities, and in turn, increase our global effective tax rate. Moreover, our existing corporate structure and intercompany arrangements have been implemented in a manner that we believe is in compliance with current prevailing tax laws. However, the tax authorities of the jurisdictions in

which we operate may challenge our methodologies for valuing developed technology or intercompany arrangements, which could impact our worldwide effective tax rate and harm our financial position and operating results.

If we are not successful in continuing to execute our strategy to increase our sales to large and medium-sized end-customers, our results of operations may suffer.

An important part of our growth strategy is to increase sales of our products to large and medium-sized businesses, service providers and government organizations. While we have increased sales in recent periods to large and medium-sized businesses, our sales volume varies by quarter and there is risk as to our level of success selling to these target customers. Such sales involve unique sales skillsets, processes and structures, are often more complex and feature a longer contract term and may be at higher discount levels. We also have experienced uneven traction selling to certain government organizations and service providers and managed security service providers (“MSSPs”), and there can be no assurance that we will be successful selling to these customers. Sales to these organizations involve risks that may not be present, or that are present to a lesser extent, with sales to smaller entities. These risks include:

- increased competition from competitors that traditionally target large and medium-sized businesses, service providers and government organizations and that may already have purchase commitments from those end-customers;
- increased purchasing power and leverage held by large end-customers in negotiating contractual arrangements;
- unanticipated changes in the capital resources or purchasing behavior of large end-customers, including changes in the volume and frequency of their purchases and changes in the mix of products and services, willingness to change to cloud delivery model and related payment terms;
- more stringent support requirements in our support service contracts, including stricter support response times, more complex requirements and increased penalties for any failure to meet support requirements;
- longer sales cycles and the associated risk that substantial time and resources may be spent on a potential end-customer that elects not to purchase our products and services;
- uncertainty as to timing to close large deals and any delays in closing those deals; and
- longer ramp-up periods for enterprise sales personnel as compared to other sales personnel.

Large and medium-sized businesses, service providers and MSSPs and government organizations often undertake a significant evaluation process that results in a lengthy sales cycle, in some cases longer than 12 months. Although we have a channel sales model, our sales representatives typically engage in direct interaction with end-customers, along with our distributors and resellers, in connection with sales to large and medium-sized end-customers. We may spend substantial time, effort and money in our sales efforts without being successful in producing any sales. In addition, purchases by large and medium-sized businesses, service providers and government organizations are frequently subject to budget constraints, multiple approvals and unplanned administrative, processing and other delays. Furthermore, service providers and MSSPs represent our largest industry vertical and consolidation or continued changes in buying behavior by larger customers within this industry could negatively impact our business. Large and medium-sized businesses, service providers and MSSPs and government organizations typically have longer implementation cycles, require greater product functionality and scalability, expect a broader range of services, including design, implementation and post go-live services, demand that vendors take on a larger share of risks, require acceptance provisions that can lead to a delay in revenue recognition and expect greater payment flexibility from vendors. In addition, large and medium-sized businesses, service providers and government organizations may require that our products and services be sold differently from how we offer our products and services, which could negatively impact our operating results. Our large business and service provider customers may also become more deliberate in their purchases as they plan their next-generation network security architecture, leading them to take more time in making purchasing decisions or to purchase based only on their immediate needs. All these factors can add further risk to business conducted with these customers. In addition, if sales expected from a large and medium-sized end-customer for a particular quarter are not realized in that quarter or at all, our business, operating results and financial condition could be materially and adversely affected.

In addition, mitigation and containment measures adopted by government authorities to contain the spread of COVID-19 in the United States and internationally, including travel restrictions and other requirements that limit in-person

meetings, could limit our ability to establish and maintain relationships with new and existing customers, which may exacerbate the risks described above.

Managing inventory of our products and product components is complex. Insufficient inventory or components may result in lost sales opportunities or delayed revenue, while excess inventory may harm our gross margins.

Managing our inventory is complex. Our channel partners may increase orders during periods of product shortages, cancel orders or not place orders commensurate with our expectations if their inventory is too high, return products or take advantage of price protection (if any is available to the particular partner) or delay orders in anticipation of new products, and accurately forecasting inventory requirements and demand can be challenging. Our channel partners also may adjust their orders in response to the supply of our products and the products of our competitors that are available to them and in response to seasonal fluctuations in end-customer demand. Furthermore, if the time required to manufacture or ship certain products increases for any reason, inventory shortfalls could result. If we cannot manufacture and ship our products due to, for example, natural disasters and health emergencies such as earthquakes, fires, power outages, typhoons, floods, pandemics and epidemics such as the COVID-19 pandemic or manmade events such as civil unrest, labor disruption, international trade disputes, international conflicts, terrorism, wars and critical infrastructure attacks, our business and financial results could be materially and adversely impacted. Management of our inventory is further complicated by the significant number of different products and models that we sell which may impact our billings, revenue, margins and free cash flow. Mismanagement of our inventory, whether due to imprecise forecasting, employee errors or malfeasance, inaccurate information or otherwise, may adversely affect our results of operations. The COVID-19 pandemic has resulted in challenges to obtaining components and inventory, as well as increases to freight and shipping costs, and may result in a material adverse effect on our results of operations.

Inventory management remains an area of focus as we balance the need to maintain inventory levels that are sufficient to ensure competitive lead times against the risk of inventory obsolescence because of rapidly changing technology, product transitions, customer requirements or excess inventory levels. If we ultimately determine that we have excess inventory, we may have to reduce our prices and write-down inventory, which in turn could result in lower gross margins. Alternatively, insufficient inventory levels may lead to shortages that result in delayed billings and revenue or loss of sales opportunities altogether as potential end-customers turn to competitors' products that are readily available. For example, we have in the past experienced inventory shortages and excesses due to the variance in demand for certain products from forecasted amounts. In addition, for those channel partners that have rights of return, inventory held by such channel partners affects our results of operations. Our inventory management systems and related supply chain visibility tools may be inadequate to enable us to effectively manage inventory. If we are unable to effectively manage our inventory and that of our channel partners, our results of operations could be adversely affected.

We are dependent on the continued services and performance of our senior management, the loss of any of whom could adversely affect our business, operating results and financial condition.

Our future performance depends on the continued services and continuing contributions of our senior management to execute on our business plan and to identify and pursue new opportunities and product innovations. The loss of services of members of senior management, particularly Ken Xie, our Co-Founder, Chief Executive Officer and Chairman, or Michael Xie, our Co-Founder, President and Chief Technology Officer, or of any of our senior sales leaders or functional area leaders, could significantly delay or prevent the achievement of our development and strategic objectives. The loss of the services or the distraction of our senior management for any reason, including the COVID-19 pandemic, could adversely affect our business, financial condition and results of operations.

If we are unable to hire, retain and motivate qualified personnel, our business will suffer.

Our future success depends, in part, on our ability to continue to attract and retain highly skilled personnel. The loss of the services of any of our key personnel, the inability to attract or retain qualified personnel, any failure to have in place and execute an effective succession plan for key executives or delays in hiring required personnel, particularly in engineering, sales and marketing, may seriously harm our business, financial condition and results of operations. From time to time, we experience turnover in our management-level personnel. None of our key employees has an employment agreement for a specific term, and any of our employees may terminate their employment at any time. Our ability to continue to attract and retain highly skilled personnel will be critical to our future success.

Competition for highly skilled personnel is frequently intense, especially for qualified sales, support and engineering employees in network security and especially in the locations where we have a substantial presence and need for highly skilled personnel, such as the San Francisco Bay Area and Vancouver, Canada. We may not be successful in attracting, assimilating or retaining qualified personnel to fulfill our current or future needs. The COVID-19 pandemic may also decelerate our hiring and

make it more challenge to entice qualified personnel to leave their current positions to join us. In addition, to the extent we hire personnel from competitors, we may be subject to allegations that they have been improperly solicited or divulged proprietary or other confidential information. Changes in immigration laws, including changes to the rules regarding H1-B visas, may also harm our ability to attract personnel from other countries. Our inability to hire properly qualified and effective sales, support and engineering employees could harm our growth and our ability to effectively support growth.

If we do not increase the effectiveness of our sales organization, we may have difficulty adding new end-customers or increasing sales to our existing end-customers and our business may be adversely affected.

Although we have a channel sales model, sales in our industry are complex and members of our sales organization often engage in direct interaction with our prospective end-customers, particularly for larger deals involving larger end-customers. Therefore, we continue to be substantially dependent on our sales organization to obtain new end-customers and sell additional products and services to our existing end-customers. There is significant competition for sales personnel with the skills and technical knowledge that we require, including experienced enterprise sales employees and others. Our ability to grow our revenue depends, in large part, on our success in recruiting, training and retaining sufficient numbers of sales personnel to support our growth and on the effectiveness of those personnel in selling successfully in different contexts, each of which has its own different complexities, approaches and competitive landscapes, such as managing and growing the channel business for sales to small businesses and more actively selling to the end-customer for sales to larger organizations. New hires require substantial training and may take significant time before they achieve full productivity. Our recent hires and planned hires may not become productive as quickly as we expect, especially in light of the COVID-19 pandemic, and we may be unable to hire or retain sufficient numbers of qualified individuals in the markets where we do business or plan to do business. Furthermore, hiring sales personnel in new countries requires additional setup and upfront costs that we may not recover if the sales personnel fail to achieve full productivity. If our sales employees do not become fully productive on the timelines that we have projected, our revenue will not increase at anticipated levels and our ability to achieve long-term projections may be negatively impacted. If we are unable to hire and train sufficient numbers of effective sales personnel, or the sales personnel are not successful in obtaining new end-customers or increasing sales to our existing customer base, our business, operating results and prospects will be adversely affected. If we do not hire properly qualified and effective sales employees and organize our sales team effectively to capture the opportunities in the various customer segments we are targeting, our growth and ability to effectively support growth would be harmed.

The sales prices of our products and services may decrease, which may reduce our gross profits and operating margin, and which may adversely impact our financial results and the trading price of our common stock.

The sales prices for our products and services may decline for a variety of reasons or our product mix may change, resulting in lower growth and margins based on a number of factors, including competitive pricing pressures, discounts or promotional programs we offer, a change in our mix of products and services and anticipation of the introduction of new products and services. Competition continues to increase in the market segments in which we participate, and we expect competition to further increase in the future, thereby leading to increased pricing pressures. Larger competitors with more diverse product offerings may reduce the price of products and services that compete with ours in order to promote the sale of other products or services or may bundle them with other products or services. Additionally, although we price our products and services worldwide in U.S. dollars, currency fluctuations in certain countries and regions have in the past, and may in the future, negatively impact actual prices that partners and customers are willing to pay in those countries and regions. Furthermore, we anticipate that the sales prices and gross profits for our products or services will decrease over product life cycles. We cannot ensure that we will be successful in developing and introducing new offerings with enhanced functionality on a timely basis, or that our product and service offerings, if introduced, will enable us to maintain our prices, gross profits and operating margin at levels that will allow us to maintain profitability.

If our internal enterprise IT networks, on which we conduct internal business and interface externally, our operational networks, through which we connect to customer systems and provide services, or our research and development networks, our back-end labs and cloud stacks through which we research and develop products and services, are compromised, public perception of our products and services may be harmed, our customers may be breached and harmed, we may become subject to liability, and our business, operating results and stock price may be adversely impacted.

Our success depends on the market's confidence in our ability to provide effective network security protection. Despite our efforts and processes to prevent breaches of our internal network system and website, we are still vulnerable to computer viruses, break-ins, phishing attacks, attempts to overload our servers with denial-of-service and other cyber-attacks and similar disruptions from unauthorized access to our internal network system or our website. Our security measures may also be breached due to employee error, malfeasance or otherwise, which breaches may be more difficult to detect than outsider threats, and the existing programs and trainings we have in place to prevent such insider threats may not be effective or

sufficient. Third parties may also attempt to fraudulently induce our employees to transfer funds or disclose information in order to gain access to our network and confidential information. Third parties may also send our customers or others malware or malicious emails that falsely indicate that we are the source, potentially causing lost confidence in us and reputational harm. We cannot guarantee that the measures we have taken to protect our network and website will provide adequate security. Moreover, because we provide network security products, we may be a more attractive target for attacks by computer hackers and any security breaches and other security incidents involving us may result in more harm to our reputation and brand than companies that do not sell network security solutions. Hackers and malicious parties may be able to develop and deploy viruses, worms, ransomware and other malicious software programs that attack our products and customers, that impersonate our update servers in an effort to access customer networks and negatively impact customers, or otherwise exploit any security vulnerabilities of our products, or attempt to fraudulently induce our employees, customers or others to disclose passwords or other sensitive information or unwittingly provide access to our internal network system or data. For example, as we previously announced, in the second quarter of 2019 we discovered that an unauthorized party targeted us using sophisticated techniques, such as efforts to impersonate our firewall update servers, in order to try to gain access to certain of our customers' systems. Although, based on our investigation of this incident, we do not believe that it had a material impact on our or our customers' businesses, and in general we take numerous measures and implement multiple layers of security to protect our network and our customers' networks, and, in this particular case, we took immediate additional action to protect our customers, we cannot guarantee that our security products and services will prevent all threats. Further, we cannot be sure that third parties have not been, or will not in the future be, successful in improperly accessing our system and our customers' systems, which could negatively impact us and our customers. An actual or perceived breach, or any other actual or perceived data security incident, that involves our network, systems or website and/or our customers' network, systems or websites, including the specific matter that is discussed above, could adversely affect the market perception of our products and services and investor confidence in our company. Any breach of our network system or website could impair our ability to operate our business, including our ability to provide FortiGuard security subscription and FortiCare technical support services to our end-customers, lead to interruptions or system slowdowns, cause loss of critical data or lead to the unauthorized disclosure or use of confidential, proprietary or sensitive information. We could also be subject to liability and litigation and reputational harm and our channel partners and end-customers may be harmed, lose confidence in us and decrease or cease using our products and services. Any breach of our internal network system or our website could have an adverse effect on our business, operating results and stock price.

In addition, due to the COVID-19 pandemic, a substantial majority of our employees are temporarily working remotely, which may pose additional data security risks. For example, there has been an increase in phishing and spam emails as well as social engineering attempts from "hackers" hoping to use the recent COVID-19 pandemic to their advantage. The risks described above could therefore be exacerbated by the COVID-19 pandemic.

Reliance on a concentration of shipments at the end of the quarter could cause our billings and revenue to fall below expected levels.

As a result of customer-buying patterns and the efforts of our sales force and channel partners to meet or exceed quarterly quotas, we have historically received a substantial portion of each quarter's sales orders and generated a substantial portion of each quarter's billings and revenue during the last two weeks of the quarter. We implemented a cloud-based quoting tool to help provide our sales team with the ability to have faster quote generation, reduce quote errors and increase sales productivity. Our ability to integrate the data from this tool into our order processing may cause order processing delays that could have an effect on our financial results. Our billings and revenue for any quarter could fall below our expectations or those of securities analysts and investors, resulting in a decline in our stock price, if expected orders at the end of any quarter are delayed for any reason or our ability to fulfill orders at the end of any quarter is hindered for any reason, including, among others:

- the failure of anticipated purchase orders to materialize;
- our logistics partners' inability to ship products prior to quarter-end to fulfill purchase orders received near the end of the quarter;
- disruption in manufacturing or shipping based on natural disasters or widespread public health problems including pandemics and epidemics such as the COVID-19 pandemic;
- our failure to accurately forecast our inventory requirements and to appropriately manage inventory to meet demand;
- our inability to release new products on schedule;

- any failure of our systems related to order review and processing; and
- any delays in shipments due to trade compliance requirements, labor disputes or logistics changes at shipping ports, airline strikes, severe weather or otherwise.

Unless we continue to develop better market awareness of our company and our products, and to improve lead generation and sales enablement, our revenue may not continue to grow.

Increased market awareness of our capabilities and products and increased lead generation are essential to our continued growth and our success in all of our markets, particularly for the large businesses, service provider and government organization market. We have historically had relatively low spending on marketing activities. While we have increased our investments in sales and marketing, it is not clear that these investments will continue to result in increased revenue. If our investments in additional sales personnel or our marketing programs are not successful in continuing to create market awareness of our company and products or increasing lead generation, or if we experience turnover and disruption in our sales and marketing teams, we will not be able to achieve sustained growth, and our business, financial condition and results of operations will be adversely affected. We are also limited in our marketing efforts as a result of the COVID-19 pandemic, as mitigation and containment measures adopted by government authorities to contain the spread of COVID-19, including travel restrictions and other requirements that limit in-person meetings, could limit our ability to establish and maintain relationships with new and existing customers and negatively affect our sales and marketing efforts.

Actual, possible or perceived defects or vulnerabilities in our products or services, the failure of our products or services to detect or prevent a security breach or the misuse of our products could harm our reputation and divert resources.

Because our products and services are complex, they have contained and may contain defects or errors that are not detected until after their commercial release and deployment by our customers. Defects or vulnerabilities may impede or block network traffic, cause our products or services to be vulnerable to electronic break-ins, cause them to fail to help secure our customers or cause our products or services to allow unauthorized access to our customers' networks. We are also susceptible to errors, defects, vulnerabilities or attacks that may arise at, or be inserted into our products in, different stages in our supply chain, or manufacturing processes, and which are out of our control. Attacks may target specific unidentified or unresolved vulnerabilities that exist or arrive only in the supply chain, making these attacks virtually impossible to anticipate and difficult to defend against. Different customers deploy and use our products in different ways, and certain deployments and usages may subject our products to adverse conditions that may negatively impact the effectiveness and useful lifetime of our products. Our networks and products, including cloud-based technology, could be targeted by attacks specifically designed to disrupt our business and harm our reputation. We cannot ensure that our products will prevent all security threats. Because the techniques used by computer hackers to access or sabotage networks change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques. In addition, defects or errors in our FortiGuard security subscription or FortiCare updates or our FortiGate appliances and operating systems could result in a failure of our FortiGuard security subscription services to effectively update end-customers' FortiGate appliances and cloud-based products and thereby leave customers vulnerable to attacks. Furthermore, our solutions may also fail to detect or prevent viruses, worms or similar threats due to a number of reasons such as the evolving nature of such threats and the continual emergence of new threats that we may fail to add to our FortiGuard databases in time to protect our end-customers' networks. Our FortiGuard or FortiCare data centers and networks may also experience technical failures and downtime, and may fail to distribute appropriate updates, or fail to meet the increased requirements of our customer base. Any such technical failure, downtime or failures in general may temporarily or permanently expose our end-customers' networks, leaving their networks unprotected against the latest security threats.

An actual, possible or perceived security breach or infection of the network of one of our end-customers, regardless of whether the breach is attributable to the failure of our products or services to prevent the security breach, could adversely affect the market's perception of our security products and services and, in some instances, subject us to potential liability that is not contractually limited. We may not be able to correct any security flaws or vulnerabilities promptly, or at all. Our products may also be misused by end-customers or third parties who obtain access to our products. For example, our products could be used to censor private access to certain information on the internet. Such use of our products for censorship could result in negative press coverage and negatively affect our reputation, even if we take reasonable measures to prevent any improper shipment of our products or if our products are provided by an unauthorized third party. Any actual, possible or perceived defects, errors or vulnerabilities in our products, or misuse of our products, could result in:

- the expenditure of significant financial and product development resources in efforts to analyze, correct, eliminate or work around errors or defects or to address and eliminate vulnerabilities;

- the loss of existing or potential end-customers or channel partners;
- delayed or lost revenue;
- delay or failure to attain market acceptance;
- negative publicity and harm to our reputation; and
- litigation, regulatory inquiries or investigations that may be costly and harm our reputation and, in some instances, subject us to potential liability that is not contractually limited.

If we do not appropriately manage any future growth, including through the expansion of our real estate facilities, or are unable to improve our systems, processes and controls, our operating results will be negatively affected.

We rely heavily on information technology to help manage critical functions such as order configuration, pricing and quoting, revenue recognition, financial forecasts, inventory and supply chain management and trade compliance reviews. In addition, we have been slow to adopt and implement certain automated functions, which could have a negative impact on our business. For example, a large part of our order processing relies on manual data entry of customer purchase orders received through email and, to a lesser extent, through electronic data interchange from our customers. Due to the use of manual processes and the fact that we may receive a large amount of our orders in the last few weeks of any given quarter, an interruption in our email service or other systems could result in delayed order fulfillment and decreased billings and revenue for that quarter.

To manage any future growth effectively, we must continue to improve and expand our information technology and financial, operating, security and administrative systems and controls, and our business continuity and disaster recovery plans and processes. We must also continue to manage headcount, capital and processes in an efficient manner. We may not be able to successfully implement requisite improvements to these systems, controls and processes, such as system capacity, access, security and change management controls, in a timely or efficient manner. Our failure to improve our systems and processes, or their failure to operate in the intended manner, whether as a result of the significant growth of our business or otherwise, may result in our inability to manage the growth of our business and to accurately forecast our revenue, expenses and earnings, or to prevent certain losses. Moreover, the failure of our systems and processes could undermine our ability to provide accurate, timely and reliable reports on our financial and operating results and could impact the effectiveness of our internal control over financial reporting.

In addition, our systems, processes and controls may not prevent or detect all errors, omissions, malfeasance or fraud, such as corruption and improper “side agreements” that may impact revenue recognition or result in financial liability. Our productivity and the quality of our products and services may also be adversely affected if we do not integrate and train our new employees quickly and effectively. Any future growth would add complexity to our organization and require effective coordination throughout our organization. Failure to ensure appropriate systems, processes and controls and to manage any future growth effectively could result in increased costs and harm our reputation and results of operations.

We have expanded our office real estate holdings to meet our projected growing need for office space. We have started construction on a second building adjacent to our headquarters as we expand our campus in Sunnyvale, California. These plans will require significant capital expenditure over the next several years and involve certain risks, including impairment charges and acceleration of depreciation, changes in future business strategy that may decrease the need for expansion (such as a decrease in headcount) and risks related to construction. Future changes in growth or fluctuations in cash flow may also negatively impact our ability to pay for these projects or free cash flow. Additionally, inaccuracies in our projected capital expenditures could negatively impact our business, operating results and financial condition.

We may experience difficulties maintaining and expanding our internal business management systems.

The maintenance of our internal business management systems, such as our Enterprise Resource Planning (“ERP”) and Customer Relationship Management (“CRM”) systems, has required, and will continue to require, the investment of significant financial and human resources. In addition, we may choose to upgrade or expand the functionality of our internal systems, leading to additional costs. We may also discover deficiencies in our design or maintenance of our internal systems that could adversely affect our ability to forecast orders, process orders, ship products, provide services and customer support, send invoices and track payments, fulfill contractual obligations, accurately maintain books and records, provide accurate,

timely and reliable reports on our financial and operating results or otherwise operate our business. Additionally, if any of our internal systems does not operate as intended, the effectiveness of our internal control over financial reporting could be adversely affected or our ability to assess it adequately could be delayed. Further, we may expand the scope of our ERP and CRM systems. Our operating results may be adversely affected if these upgrades or expansions are delayed or if the systems do not function as intended or are not sufficient to meet our operating requirements.

If our estimates or judgments relating to our critical accounting policies are based on assumptions that change or prove to be incorrect, our operating results could fall below expectations of securities analysts and investors, resulting in a decline in our stock price.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, as provided in “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies and Estimates” in this Quarterly Report on Form 10-Q, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Our operating results may be adversely affected if our assumptions change or if actual circumstances differ from those in our assumptions, which could cause our operating results to fall below the expectations of securities analysts and investors, resulting in a decline in our stock price. Significant assumptions and estimates used in preparing our consolidated financial statements include those related to revenue recognition, deferred contract costs and commission expense, valuation of inventory, accounting for business combination, contingent liabilities and accounting for income taxes.

We offer retroactive price protection to certain of our major distributors, and if we fail to balance their inventory with end-customer demand for our products, our allowance for price protection may be inadequate, which could adversely affect our results of operations.

We provide certain of our major distributors with price protection rights for inventories of our products held by them. If we reduce the list price of our products, certain distributors receive refunds or credits from us that reduce the price of such products held in their inventory based upon the new list price. Future credits for price protection will depend on the percentage of our price reductions for the products in inventory and our ability to manage the levels of our major distributors’ inventories. If future price protection adjustments are higher than expected, our future results of operations could be materially and adversely affected.

Because we depend on several third-party manufacturers to build our products, we are susceptible to manufacturing delays that could prevent us from shipping customer orders on time, if at all, and may result in the loss of sales and customers, and third-party manufacturing cost increases could result in lower gross margins and free cash flow.

We outsource the manufacturing of our security appliance products to contract manufacturing partners and original design manufacturing partners, including manufacturers with facilities located in Taiwan, China and other countries outside the United States such as Micro-Star, Wistron, Senao, ADLINK and IBASE. Our reliance on our third-party manufacturers in Asia and elsewhere reduces our control over the manufacturing process, exposing us to risks, including reduced control over quality assurance, costs, supply and timing and possible tariffs. Any manufacturing disruption related to our third-party manufacturers or their component suppliers for any reason, including natural disasters and health emergencies such as earthquakes, fires, power outages, typhoons, floods, health pandemics and epidemics such as the COVID-19 pandemic and manmade events such as civil unrest, labor disruption, international trade disputes, international conflicts, terrorism, wars and critical infrastructure attacks, could impair our ability to fulfill orders. If we are unable to manage our relationships with these third-party manufacturers effectively, or if these third-party manufacturers experience delays, increased manufacturing lead-times, disruptions, capacity constraints or quality control problems in their manufacturing operations, or fail to meet our future requirements for timely delivery, our ability to ship products to our customers could be impaired and our business would be seriously harmed.

These manufacturers fulfill our supply requirements on the basis of individual purchase orders. We have no long-term contracts or arrangements with our third-party manufacturers that guarantee capacity, the continuation of particular payment terms or the extension of credit limits. Accordingly, they are not obligated to continue to fulfill our supply requirements, and the prices we are charged for manufacturing services could be increased on short notice. If we are required to change third-party manufacturers, our ability to meet our scheduled product deliveries to our customers would be adversely affected, which could cause the loss of sales and existing or potential customers, delayed revenue or an increase in our costs, which could adversely affect our gross margins. Our individual product lines are generally manufactured by only one manufacturing partner. Any production or shipping interruptions for any reason, such as a natural disaster, epidemic, capacity shortages, quality

problems or strike or other labor disruption at one of our manufacturing partners or locations or at shipping ports or locations, would severely affect sales of our product lines manufactured by that manufacturing partner. Furthermore, manufacturing cost increases for any reason could result in lower gross margins.

Our proprietary SPUs, which are key to the performance of our appliances, are built by contract manufacturers including Renesas and Toshiba. These contract manufacturers use foundries operated by TSMC or Renesas on a purchase-order basis, and these foundries do not guarantee their capacity and could delay orders or increase their pricing. Accordingly, the foundries are not obligated to continue to fulfill our supply requirements, and due to the long lead time that a new foundry would require, we could suffer inventory shortages of our SPU as well as increased costs. In addition to our proprietary SPU, we also purchase off-the-shelf ASICs or integrated circuits from vendors for which we have experienced, and may continue to experience, long lead times. Our suppliers may also prioritize orders by other companies that order higher volumes or more profitable products. If any of these manufacturers materially delays its supply of ASICs or specific product models to us, or requires us to find an alternate supplier and we are not able to do so on a timely and reasonable basis, or if these foundries materially increase their prices for fabrication of our ASICs, our business would be harmed.

In addition, our reliance on third-party manufacturers and foundries limits our control over environmental regulatory requirements such as the hazardous substance content of our products and therefore our ability to ensure compliance with the Restriction of Hazardous Substances Directive (the “EU RoHS”) adopted in the European Union (the “EU”) and other similar laws. It also exposes us to the risk that certain minerals and metals, known as “conflict minerals,” that are contained in our products have originated in the Democratic Republic of the Congo or an adjoining country. As a result of the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank”), the SEC adopted disclosure requirements for public companies whose products contain conflict minerals that are necessary to the functionality or production of such products. Under these rules, we are required to obtain sourcing data from suppliers, perform supply chain due diligence, and file annually with the SEC a specialized disclosure report on Form SD covering the prior calendar year. We have incurred and expect to incur additional costs to comply with the rules, including costs related to efforts to determine the origin, source and chain of custody of the conflict minerals used in our products and the adoption of conflict minerals-related governance policies, processes and controls. Moreover, the implementation of these compliance measures could adversely affect the sourcing, availability and pricing of materials used in the manufacture of our products to the extent that there may be only a limited number of suppliers that are able to meet our sourcing requirements, which would make it more difficult to obtain such materials in sufficient quantities or at competitive prices. We may also encounter customers who require that all of the components of our products be certified as conflict-free. If we are not able to meet customer requirements, such customers may choose to not purchase our products, which could impact our sales and the value of portions of our inventory.

Because some of the key components in our products come from limited sources of supply, we are susceptible to supply shortages, long lead times for components, and supply changes, each of which could disrupt or delay our scheduled product deliveries to our customers, result in inventory shortage, cause loss of sales and customers or increase component costs resulting in lower gross margins and free cash flow.

We and our contract manufacturers currently purchase several key parts and components used in the manufacture of our products from limited sources of supply. We are therefore subject to the risk of shortages and long lead times in the supply of these components and the risk that component suppliers may discontinue or modify components used in our products. We have in the past experienced, and are currently experiencing, shortages and long lead times for certain components. Our limited source components for particular appliances and suppliers of those components include specific types of CPUs from Intel, network chips from Broadcom, Marvell and Intel, and memory devices from Intel, ADATA, Toshiba, Samsung and Western Digital. We also may face shortages in the supply of the capacitors and resistors that are used in the manufacturing of our products. The introduction by component suppliers of new versions of their products, particularly if not anticipated by us or our contract manufacturers, could require us to expend significant resources to incorporate these new components into our products. In addition, if these suppliers were to discontinue production of a necessary part or component, we would be required to expend significant resources and time in locating and integrating replacement parts or components from another vendor. Qualifying additional suppliers for limited source parts or components can be time-consuming and expensive.

Our manufacturing partners have experienced long lead times for the purchase of components incorporated into our products. Lead times for components may be adversely impacted by factors outside of our control such as natural disasters and health emergencies such as earthquakes, fires, power outages, typhoons, floods, health pandemics and epidemics such as the COVID-19 pandemic, and manmade events such as civil unrest, labor disruption, international trade disputes, international conflicts, terrorism, wars, critical infrastructure attacks and other factors. Our reliance on a limited number of suppliers involves several additional risks, including:

- a potential inability to obtain an adequate supply of required parts or components when required;

- financial or other difficulties faced by our suppliers;
- infringement or misappropriation of our IP;
- price increases;
- failure of a component to meet environmental or other regulatory requirements;
- failure to meet delivery obligations in a timely fashion;
- failure in component quality; and
- inability to ship products on a timely basis.

The occurrence of any of these events would be disruptive to us and could seriously harm our business. Any interruption or delay in the supply of any of these parts or components, or the inability to obtain these parts or components from alternate sources at acceptable prices and within a reasonable amount of time, would harm our ability to meet our scheduled product deliveries to our distributors, resellers and end-customers. This could harm our relationships with our channel partners and end-customers and could cause delays in shipment of our products and adversely affect our results of operations. In addition, increased component costs could result in lower gross margins.

We are exposed to fluctuations in currency exchange rates, which could negatively affect our financial condition and results of operations.

A significant portion of our operating expenses are incurred outside the United States. These expenses are denominated in foreign currencies and are subject to fluctuations due to changes in foreign currency exchange rates, particularly changes in the Euro, Brazilian real, Canadian dollar and British pound. Additionally, fluctuations in the exchange rate of the Canadian dollar may negatively impact our development plans in Burnaby, Canada. While we are not currently engaged in material hedging activities, we have been hedging currency exposures relating to certain balance sheet accounts through the use of forward exchange contracts. If we stop hedging against any of these risks or if our attempts to hedge against these currency exposures are not successful, our financial condition and results of operations could be adversely affected. Our sales contracts are primarily denominated in U.S. dollars and therefore, while substantially all of our revenue is not subject to foreign currency risk, it does not serve as a hedge to our foreign currency-denominated operating expenses. In addition, a strengthening of the U.S. dollar may increase the real cost of our products to our customers outside of the United States, which may also adversely affect our financial condition and results of operations.

Failure to comply with laws and regulations applicable to our business could subject us to fines and penalties and could also cause us to lose end-customers in the public sector or negatively impact our ability to contract with the public sector.

Our business is subject to regulation by various federal, state, regional, local and foreign governmental agencies, including agencies responsible for monitoring and enforcing employment and labor laws, workplace safety, product safety, product labeling, environmental laws, consumer protection laws, anti-bribery laws, data privacy laws, import and export controls, federal securities laws and tax laws and regulations. In certain jurisdictions, these regulatory requirements may be more stringent than in the United States. Non-compliance with applicable regulations or requirements could subject us to investigations, sanctions, enforcement actions, disgorgement of profits, fines, damages and civil and criminal penalties or injunctions. If any governmental sanctions are imposed, or if we do not prevail in any possible civil or criminal litigation, our business, operating results and financial condition could be adversely affected. In addition, responding to any action will likely result in a significant diversion of management's attention and resources and an increase in professional fees. Enforcement actions and sanctions could harm our business, operating results and financial condition.

For example, the GDPR, which became effective in May 2018 and superseded current EU data protection regulations, imposes stringent data handling requirements on companies that receive or process personal data of residents of the EU. Non-compliance with the GDPR could result in significant penalties, including data protection audits and heavy fines. Compliance with, and the other burdens imposed by, the GDPR may limit our ability to operate or expand our business in Europe and could adversely impact our operating results, as could delays or shortcomings in the implementation of our GDPR compliance program.

Additionally, we may be subject to other legal regimes throughout the world governing data handling, protection and privacy. For example, in June 2018, California passed the California Consumer Privacy Act (the “CCPA”), which provides new data privacy rights for consumers and new operational requirements for companies and became effective on January 1, 2020. Fines for non-compliance may be up to \$7,500 per violation. The costs of compliance with, and other burdens imposed by, the GDPR and CCPA may limit the use and adoption of our products and services and could have an adverse impact on our business.

Selling our solutions to the U.S. government, whether directly or through channel partners, also subjects us to certain regulatory and contractual requirements and risks. Failure to comply with these requirements by either us or our channel partners could subject us to investigations, fines, suspension or debarment from doing business with the U.S. government or one of its divisions, and other penalties and damages, which could have an adverse effect on our business, operating results, financial condition and prospects. As an example, the U.S. Department of Justice has in the past pursued claims against, and obtained monetary settlements or damages from, companies, including us, under the False Claims Act and other statutes related to pricing, discount practices and compliance with laws related to sales to the federal government, such as the Trade Agreements Act (the “TAA”). Any violations of regulatory and contractual requirements could result in us being suspended or debarred from future government contracting. Any of these outcomes could have an adverse effect on our revenue, operating results, financial condition and prospects.

These laws and regulations impose added costs on our business, and failure to comply with these or other applicable regulations and requirements, including non-compliance in the past, could lead to claims for damages from our channel partners, penalties, termination of contracts, loss of exclusive rights in our IP and temporary suspension or permanent debarment from government contracting. Any such damages, penalties, disruptions or limitations in our ability to do business with the public sector could have an adverse effect on our business and operating results.

Global economic uncertainty and weakening product demand caused by political instability and conflict could adversely affect our business and financial performance.

Economic uncertainty in various global markets caused by political instability and conflict has resulted, and may continue to result, in weakened demand for our products and services and difficulty in forecasting our financial results and managing inventory levels. Political developments impacting government spending and international trade, including potential government shutdowns and election year instability in the United States, continued uncertainty surrounding the United Kingdom’s departure from the EU and trade disputes and tariffs, may negatively impact markets and cause weaker macro-economic conditions. The effects of these events may continue due to potential additional U.S. government shutdowns and developments resulting from the 2020 presidential election, instability in the United Kingdom and the EU as negotiations for the terms of Brexit continue, with the ultimate outcome still uncertain, and the United States’ ongoing trade disputes with China and other countries. The continuing effect of any or all of these events could adversely impact demand for our products, harm our operations and weaken our financial results.

We are subject to governmental export and import controls that could subject us to liability or restrictions on sales, and that could impair our ability to compete in international markets.

Because we incorporate encryption technology into our products, certain of our products are subject to U.S. export controls and may be exported outside the United States only with the required export license or through an export license exception, or may be prohibited altogether from export to certain countries. If we were to fail to comply with U.S. export laws, U.S. Customs regulations and import regulations, U.S. economic sanctions and other countries’ import and export laws, we could be subject to substantial civil and criminal penalties, including fines for the company and incarceration for responsible employees and managers, and the possible loss of export or import privileges. In addition, if our channel partners fail to obtain appropriate import, export or re-export licenses or permits (e.g. for stocking orders placed by our partners), we may also be adversely affected through reputational harm and penalties and we may not be able to provide support related to appliances shipped pursuant to such orders. Obtaining the necessary export license for a particular sale may be time-consuming and may result in the delay or loss of sales opportunities.

Furthermore, U.S. export control laws and economic sanctions prohibit the shipment of certain products to U.S. embargoed or sanctioned countries, governments and persons. Even though we take precautions to prevent our product from being shipped to U.S. sanctions targets, our products could be shipped to those targets by our channel partners, despite such precautions. Any such shipment could have negative consequences including government investigations and penalties and reputational harm. In addition, various countries regulate the import of certain encryption technology, including import permitting and licensing requirements, and have enacted laws that could limit our ability to distribute our products or could limit our customers’ ability to implement our products in those countries. Changes in our products or changes in export and

import regulations may create delays in the introduction of our products in international markets, prevent our customers with international operations from deploying our products globally or, in some cases, prevent the export or import of our products to certain countries, governments or persons altogether. Any change in export or import regulations, economic sanctions or related legislation, shift in the enforcement or scope of existing regulations, or change in the countries, governments, persons or technologies targeted by such regulations, could result in decreased use of our products by, or in our decreased ability to export or sell our products to, existing or potential customers with international operations. Any decreased use of our products or limitation on our ability to export or sell our products would likely adversely affect our business, financial condition and results of operations.

Efforts to withdraw from or materially modify international trade agreements, to change tax provisions related to global manufacturing and sales or to impose new tariffs, economic sanctions or related legislation, any of which could adversely affect our financial condition and results of operations.

Our business benefits directly and indirectly from free trade agreements, and we also rely on various U.S. corporate tax provisions related to international commerce, as we develop, market and sell our products and services globally. Efforts to withdraw from or materially modify international trade agreements, or to change corporate tax policy related to international commerce, could adversely affect our financial condition and results of operations as could the continuing uncertainty regarding whether such actions will be taken.

Moreover, efforts to implement changes related to export or import regulations (including the imposition of new border taxes or tariffs on foreign imports), trade barriers, economic sanctions and other related policies could harm our results of operations. For example, during 2018 and 2019 the United States imposed additional import tariffs on certain goods from different countries and on most of Chinese imported goods. As a result, China and other countries imposed retaliatory tariffs on goods exported from the United States and both the United States and foreign countries have threatened to alter or leave current trade agreements. While we do not currently expect these tariffs to have a significant effect on our raw material and product import costs, if the United States expands increased tariffs, or retaliatory trade measures are taken by China or other countries in response to the tariffs, the cost of our products could increase, our operations could be disrupted or we could be required to raise our prices, which may result in the loss of customers and harm to our reputation and operating performance.

Any modification in these areas, any shift in the enforcement or scope of existing regulations or any change in the countries, governments, persons or technologies targeted by such regulations, could result in decreased use of our products by, or in our decreased ability to export or sell our products to, existing or potential end-customers with international operations and could result in increased costs. Any decreased use of our products or limitation on our ability to export or sell our products would likely adversely affect our business, financial condition and results of operations.

If we fail to comply with environmental requirements, our business, financial condition, operating results and reputation could be adversely affected.

We are subject to various environmental laws and regulations, including laws governing the hazardous material content of our products, laws relating to our real property and future expansion plans and laws concerning the recycling of electrical and electronic equipment. The laws and regulations to which we are subject include the EU RoHS Directive, EU Registration, Evaluation, Authorization and Restriction of Chemicals and the EU Waste Electrical and Electronic Equipment Directive (the "WEEE Directive"), as well as the implementing legislation of the EU member states. Similar laws and regulations have been passed or are pending in China, South Korea, Norway and Japan and may be enacted in other regions, including in the United States, and we are, or may in the future be, subject to these laws and regulations.

The EU RoHS Directive and the similar laws of other jurisdictions ban or restrict the presence of certain hazardous substances such as lead, mercury, cadmium, hexavalent chromium and certain fire-retardant plastic additives in electrical equipment, including our products. We have incurred costs to comply with these laws, including research and development costs, costs associated with assuring the supply of compliant components and costs associated with writing off scrapped noncompliant inventory. We expect to continue to incur costs related to environmental laws and regulations in the future. With respect to the EU RoHS, we and our competitors rely on exemptions for lead and other substances in network infrastructure equipment. It is possible one or more of these use exemptions will be revoked in the future. Additionally, although some of the EU RoHS exemptions have been extended, it is possible that some of these exemptions may expire in the future without being extended. If this exemption is revoked or expires without extension, if there are other changes to these laws (or their interpretation) or if new similar laws are passed in other jurisdictions, we may be required to re-engineer our products to use components compatible with these regulations. This re-engineering and component substitution could result in additional costs to us and/or disrupt our operations or logistics.

The EU has also adopted the WEEE Directive, which requires electronic goods producers to be responsible for the collection, recycling and treatment of such products. Although currently our EU international channel partners are responsible for the requirements of this directive as the importer of record in most of the European countries in which we sell our products, changes in interpretation of the regulations may cause us to incur costs or have additional regulatory requirements in the future to meet in order to comply with this directive, or with any similar laws adopted in other jurisdictions.

Our failure to comply with these and future environmental rules and regulations could result in reduced sales of our products, increased costs, substantial product inventory write-offs, reputational damage, penalties and other sanctions.

A portion of our revenue is generated by sales to government organizations, which are subject to a number of challenges and risks.

Sales to U.S. and foreign federal, state and local governmental agency end-customers have accounted for a portion of our revenue in past periods, and we may in the future increase sales to government organizations. Sales to government organizations are subject to a number of risks. Selling to government organizations can be highly competitive, expensive and time consuming, often requiring significant upfront time and expense, with long sales cycles and without any assurance of winning a sale.

Government demand, sales and payment for our products and services may be negatively impacted by numerous factors and requirements unique to selling to government agencies, such as:

- public sector budgetary cycles;
- funding authorizations and requirements unique to government agencies, with funding or purchasing reductions or delays adversely affecting public sector demand for our products;
- geopolitical matters, including tariff and trade disputes, Brexit and government shutdowns; and
- rules and regulations applicable to certain government sales, including GSA regulations.

Government spending may also be negatively impacted by the COVID-19 pandemic.

The rules and regulations applicable to sales to government organizations may also negatively impact sales to other organizations. To date, we have had limited traction in sales to U.S. federal government agencies, and any future sales to government organizations is uncertain. Government organizations may have contractual or other legal rights to terminate contracts with our distributors and resellers for convenience or due to a default, and any such termination may adversely impact our future results of operations. For example, if the distributor receives a significant portion of its revenue from sales to such government organization, the financial health of the distributor could be substantially harmed, which could negatively affect our future sales to such distributor. Governments routinely investigate, review and audit government vendors' administrative and other processes, and any unfavorable investigation, audit or other review could result in the government's refusing to continue buying our products and services, a reduction of revenue or fines, or civil or criminal liability if the investigation, audit or other review uncovers improper, illegal or otherwise concerning activities. Any such penalties could adversely impact our results of operations in a material way. Finally, purchases by the U.S. government may require certain products to be manufactured in the United States and other high cost manufacturing locations, and we may not manufacture all products in locations that meet the requirements of the U.S. government.

False detection of vulnerabilities, viruses or security breaches or false identification of spam or spyware could adversely affect our business.

Our FortiGuard security subscription services may falsely detect, report and act on viruses or other threats that do not actually exist. This risk is heightened by the inclusion of a "heuristics" feature in our products, which attempts to identify viruses and other threats not based on any known signatures but based on characteristics or anomalies that may indicate that a particular item is a threat. When our end-customers enable the heuristics feature in our products, the risk of falsely identifying viruses and other threats significantly increases. These false positives, while typical in the industry, may impair the perceived reliability of our products and may therefore adversely impact market acceptance of our products. Also, our FortiGuard security subscription services may falsely identify emails or programs as unwanted spam or potentially unwanted programs, or alternatively fail to properly identify unwanted emails or programs, particularly as spam emails or spyware are often designed to circumvent anti-spam or spyware products. Parties whose emails or programs are blocked by our products may seek redress against us for labeling them as spammers or spyware, or for interfering with their business. In addition, false identification of

emails or programs as unwanted spam or potentially unwanted programs may reduce the adoption of our products. If our system restricts important files or applications based on falsely identifying them as malware or some other item that should be restricted, this could adversely affect end-customers' systems and cause material system failures. In addition, our threat researchers periodically identify vulnerabilities in various third-party products, and, if these identifications are perceived to be incorrect or are in fact incorrect, this could harm our business. Any such false identification or perceived false identification of important files, applications or vulnerabilities could result in negative publicity, loss of end-customers and sales, increased costs to remedy any problem and costly litigation.

Our ability to sell our products is dependent on the quality of our technical support services, and our failure to offer high-quality technical support services would have a material adverse effect on our sales and results of operations.

Once our products are deployed within our end-customers' networks, our end-customers depend on our technical support services, as well as the support of our channel partners and other third parties, to resolve any issues relating to our products. If we, our channel partners or other third parties do not effectively assist our customers in planning, deploying and operational proficiency for our products, succeed in helping our customers quickly resolve post-deployment issues and provide effective ongoing support, our ability to sell additional products and services to existing customers would be adversely affected and our reputation with potential customers could be damaged. Many large end-customers, and service provider or government organization end-customers, require higher levels of support than smaller end-customers because of their more complex deployments and more demanding environments and business models. If we, our channel partners or other third parties fail to meet the requirements of our larger end-customers, it may be more difficult to execute on our strategy to increase our penetration with large businesses, service providers and government organizations. Our failure to maintain high-quality support services would have a material adverse effect on our business, financial condition and results of operations and may subject us to litigation, reputational damage, loss of customers and additional costs.

We could be subject to changes in our tax rates, the adoption of new U.S. or international tax legislation or exposure to additional tax liabilities.

We are subject to taxes in the United States and numerous foreign jurisdictions, where a number of our subsidiaries are organized. Our provision for income taxes is subject to volatility and could be adversely affected by several factors, many of which are outside of our control. These include:

- the mix of earnings in countries with differing statutory tax rates or withholding taxes;
- changes in the valuation of our deferred tax assets and liabilities;
- transfer pricing adjustments;
- an increase in non-deductible expenses for tax purposes, including certain stock-based compensation expense;
- changes in availability of tax credits and/or tax deductions;
- tax costs related to intercompany realignments;
- tax assessments resulting from income tax audits or any related tax interest or penalties that could significantly affect our provision for income taxes for the period in which the settlement takes place; and
- changes in accounting principles, court decisions, tax rulings, and interpretations of or changes to tax laws, and regulations by international, federal or local governmental authorities.

We have open tax years that could be subject to the examination by the Internal Revenue Service (the "IRS") and other tax authorities. We currently have ongoing tax audits in the United Kingdom, Canada and several other foreign jurisdictions. The focus of all of these audits is the allocation of profit between our legal entities. We regularly assess the likelihood of adverse outcomes resulting from such examinations to determine the adequacy of our provision for income taxes. Although we believe that our estimates are reasonable, the ultimate tax outcome may differ from the amounts recorded in our consolidated financial statements and may materially affect our financial results.

On June 7, 2019, the Ninth Circuit issued an opinion in *Altera Corporation and Subsidiaries vs. Commissioner of Internal Revenue* that reversed the Tax Court Decision in favor of the IRS. The opinion ruled in favor of the IRS, stating that stock compensation must be included in cost sharing. Based on this decision, in the second quarter of 2019, we recorded a reserve for uncertain tax positions for this potential tax liability. On February 10, 2020, the Ninth Circuit decision was appealed to the Supreme Court of the United States. We will continue to monitor and assess the impact as this case moves forward.

We may undertake corporate operating restructurings or transfers of assets that involve our group of foreign country subsidiaries through which we do business abroad, in order to maximize the operational and tax efficiency of our group structure. If ineffectual, such restructurings or transfers could increase our income tax liabilities, and in turn, increase our global effective tax rate. Moreover, our existing corporate structure and intercompany arrangements have been implemented in a manner that we believe is in compliance with current prevailing tax laws. However, the tax authorities of the jurisdictions in which we operate may challenge our methodologies for valuing developed technology or intercompany arrangements, which could impact our worldwide effective tax rate and harm our financial position and operating results.

Significant judgment is required in determining any valuation allowance recorded against deferred tax assets. In assessing the need for a valuation allowance, we consider all available evidence, including past operating results, estimates of future taxable income and the feasibility of tax planning strategies. In the event that we change our determination as to the amount of deferred tax assets that can be realized, we will adjust our valuation allowance with a corresponding impact to the provision for income taxes in the period in which such determination is made.

Forecasting our estimated annual effective tax rate is complex and subject to uncertainty, and there may be material differences between our forecasted and actual tax rates.

Forecasts of our income tax position and effective tax rate are complex, subject to uncertainty and periodic updates because our income tax position for each year combines the effects of a mix of profits earned and losses incurred by us in various tax jurisdictions with a broad range of income tax rates, as well as changes in the valuation of deferred tax assets and liabilities, the impact of various accounting rules and changes to these rules and tax laws, the results of examinations by various tax authorities, and the impact of any acquisition, business combination or other reorganization or financing transaction. To forecast our global tax rate, we estimate our pre-tax profits and losses by jurisdiction and forecast our tax expense by jurisdiction. If the mix of profits and losses, our ability to use tax credits or effective tax rates in a given jurisdiction differs from our estimate, our actual tax rate could be materially different than forecasted, which could have a material impact on our results of business, financial condition and results of operations. Additionally, our actual tax rate may be subject to further uncertainty due to potential changes in U.S. and foreign tax rules.

As a multinational corporation, we conduct our business in many countries and are subject to taxation in many jurisdictions. The taxation of our business is subject to the application of multiple and sometimes conflicting tax laws and regulations, as well as multinational tax conventions. Our effective tax rate is highly dependent upon the geographic distribution of our worldwide earnings or losses, the tax regulations and tax holidays in each geographic region, the availability of tax credits and carryforwards and the effectiveness of our tax planning strategies. The application of tax laws and regulations is subject to legal and factual interpretation, judgment and uncertainty. Tax laws themselves are subject to change as a result of changes in fiscal policy, changes in legislation and the evolution of regulations and court rulings. Consequently, tax authorities may impose tax assessments or judgments against us that could materially impact our tax liability and/or our effective income tax rate.

The Organisation for Economic Co-operation and Development (the "OECD"), an international association comprised of 36 countries, including the United States, has issued and continues to issue guidelines and proposals that change various aspects of the existing framework under which our tax obligations are determined in many of the countries in which we do business. Due to our extensive international business activities, any changes in the taxation of such activities could increase our tax obligations in many countries and may increase our worldwide effective tax rate.

Our inability to acquire and integrate other businesses, products or technologies could seriously harm our competitive position.

In order to remain competitive, we may seek to acquire additional businesses, products, technologies or IP, such as patents. For example, we closed our acquisitions of enSilo and CyberSponse in the fourth quarter of 2019. For any possible future acquisitions, we may not be successful in negotiating the terms of the acquisition or financing the acquisition. For both our prior and future acquisitions, we may not be successful in effectively integrating the acquired business, product, technology or IP and sales force into our existing business and operations. We may have difficulty incorporating acquired technologies, IP or products with our existing product lines, integrating reporting systems and procedures, and maintaining uniform standards,

controls, procedures and policies. For example, we may experience difficulties integrating an acquired company's ERP or CRM systems, sales support and other processes and systems, with our current systems and processes. Our due diligence may fail to identify all of the problems, liabilities or other shortcomings or challenges of an acquired business, product or technology, including issues with IP, product quality or product architecture, regulatory compliance practices, revenue recognition or other accounting practices or employee or customer issues, and we may not accurately forecast the financial impact of an acquisition. In addition, any acquisitions we are able to complete may be dilutive to revenue growth and earnings and may not result in any synergies or other benefits we had expected to achieve, which could result in impairment charges that could be substantial. We may have to pay cash, incur debt or issue equity securities to pay for any acquisition, each of which could affect our financial condition or the value of our capital stock and could result in dilution to our stockholders. Acquisitions during a quarter may result in increased operating expenses and adversely affect our results of operations for that period or future periods compared to the results that we have previously forecasted or achieved. Further, completing a potential acquisition and integrating acquired businesses, products, technologies or IP could significantly divert management time and resources.

Our business is subject to the risks of warranty claims, product returns, product liability and product defects.

Our products are very complex and, despite testing prior to their release, have contained and may contain undetected defects or errors, especially when first introduced or when new versions are released. Product errors have affected the performance and effectiveness of our products and could delay the development or release of new products or new versions of products, adversely affect our reputation and our end-customers' willingness to buy products from us, result in litigation and disputes with customers and adversely affect market acceptance or perception of our products. Any such errors or delays in releasing new products or new versions of products or allegations of unsatisfactory performance could cause us to lose revenue or market share, increase our service costs, cause us to incur substantial costs in redesigning the products, cause us to lose significant end-customers, subject us to litigation, litigation costs and liability for damages and divert our resources from other tasks, any one of which could materially and adversely affect our business, results of operations and financial condition. Our products must successfully interoperate with products from other vendors. As a result, when problems occur in a network, it may be difficult to identify the sources of these problems. The occurrence of hardware and software errors, whether or not caused by our products, could delay or reduce market acceptance of our products and have an adverse effect on our business and financial performance, and any necessary revisions may cause us to incur significant expenses. The occurrence of any such problems could harm our business, financial condition and results of operations.

Although we generally have limitation of liability provisions in our standard terms and conditions of sale, they may not fully or effectively protect us from claims if exceptions apply or if the provisions are deemed unenforceable, and in some circumstances we may be required to indemnify a customer in full, without limitation, for certain liabilities, including liabilities that are not contractually limited. The sale and support of our products also entail the risk of product liability claims. We maintain insurance to protect against certain claims associated with the use of our products, but our insurance coverage may not adequately cover any claim asserted against us, if at all, and in some instances may subject us to potential liability that is not contractually limited. In addition, even claims that ultimately are unsuccessful could result in our expenditure of funds in litigation and divert management's time and other resources.

Our business is subject to the risks of earthquakes, fire, power outages, typhoon, floods, virus outbreaks and other broad health-related challenges and other catastrophic events, and to interruption by manmade problems such as civil unrest, labor disruption, critical infrastructure attack and terrorism.

A significant natural disaster, such as an earthquake, fire, power outage, flood, viral outbreak or other catastrophic event, could have a material adverse impact on our business, operating results and financial condition. Our corporate headquarters are located in the San Francisco Bay Area, a region known for seismic activity, and our research and development and data center in Burnaby, Canada, from which we deliver to customers our FortiGuard security subscription updates, is subject to the risk of flooding and is also in a region known for seismic activity. Any earthquake in the Bay Area or Burnaby, or flooding in Burnaby, could materially negatively impact our ability to provide products and services, such as FortiCare support and FortiGuard subscription services and could otherwise materially negatively impact our business. In addition, natural disasters could affect our manufacturing vendors, suppliers or logistics providers' ability to perform services, such as obtaining product components and manufacturing products, or performing or assisting with shipments, on a timely basis, as well as our customers' ability to order from us and our employees' ability to perform their duties. For example, a typhoon in Taiwan could materially negatively impact our ability to ship products and could result in delays and reductions in billings and revenues, and the COVID-19 pandemic will negatively impact our ability to manufacture and ship products, possibly in a material way, and could result in delays and reductions in billings and revenues, also possibly in a material way. In the event our or our service providers' information technology systems or manufacturing or logistics abilities are hindered by any of the events discussed above, shipments could be delayed, resulting in our missing financial targets, such as revenue and shipment targets, for a particular quarter. In addition, regional instability, civil unrest, labor disruptions, acts of terrorism and other geo-political unrest

could cause disruptions in our business or the business of our manufacturers, logistics providers, partners or end-customers, or of the economy as a whole. Given our typical concentration of sales at the end of each quarter, any disruption in the business of our manufacturers, logistics providers, partners or end-customers that impacts sales at the end of our quarter could have a significant adverse impact on our quarterly results. To the extent that any of the above results in security risks to our customers, delays or cancellations of customer orders, the delay of the manufacture, deployment or shipment of our products or interruption or downtime of our services, our business, financial condition and results of operations would be adversely affected.

Risks Related to Our Industry

The network security market is rapidly evolving and the complex technology incorporated in our products makes them difficult to develop. If we do not accurately predict, prepare for and respond promptly to technological and market developments and changing end-customer needs, our competitive position and prospects may be harmed.

The network security market is expected to continue to evolve rapidly. Moreover, many of our end-customers operate in markets characterized by rapidly changing technologies and business plans, which require them to add numerous network access points and adapt increasingly complex networks, incorporating a variety of hardware, software applications, operating systems and networking protocols. In addition, computer hackers and others who try to attack networks employ increasingly sophisticated techniques to gain access to and attack systems and networks. The technology in our products is especially complex because it needs to effectively identify and respond to new and increasingly sophisticated methods of attack, while minimizing the impact on network performance. Additionally, some of our new products and enhancements may require us to develop new hardware architectures and ASICs that involve complex, expensive and time-consuming research and development processes. For example, we enter into development agreements with third parties. If our contract development projects are not successfully completed, or are not completed in a timely fashion, our product development could be delayed and our business generally could suffer. Costs for contract development can be substantial and our profitability may be harmed if we are unable to recover these costs. Although the market expects rapid introduction of new products or product enhancements to respond to new threats, the development of these products is difficult and the timetable for commercial release and availability is uncertain and there can be long time periods between releases and availability of new products. We have in the past and may in the future experience unanticipated delays in the availability of new products and services and fail to meet previously announced timetables for such availability. If we do not quickly respond to the rapidly changing and rigorous needs of our end-customers by developing and releasing and making available on a timely basis new products and services or enhancements that can respond adequately to new security threats, our competitive position and business prospects may be harmed.

Moreover, business models based on SaaS, either hosted or cloud-based services, have become increasingly in-demand by our end-customers and adopted by other providers, including our competitors. While we have introduced additional cloud-based products and services and will continue to do so, most of our platform is currently deployed on premise, and therefore, if customers demand that our platform be provided through a SaaS business model, we would be required to make additional investments in our infrastructure and personnel to be able to more fully provide our platform through a SaaS model in order to maintain the competitiveness of our platform. Such investments may involve expanding our data centers, servers and networks, and increasing our technical operations and engineering teams. These risks are compounded by the uncertainty concerning the future viability of SaaS business models and the future demand for such models by customers. Additionally, if we are unable to meet the demand to provide our services through a SaaS model, we may lose customers to competitors.

Our uniform resource locator (“URL”) database for our web filtering service may fail to keep pace with the rapid growth of URLs and may not categorize websites in accordance with our end-customers’ expectations.

The success of our web filtering service depends on the breadth and accuracy of our URL database. Although our URL database currently catalogs millions of unique URLs, it contains only a portion of the URLs for all of the websites that are available on the internet. In addition, the total number of URLs and software applications is growing rapidly, and we expect this rapid growth to continue in the future. Accordingly, we must identify and categorize content for our security risk categories at an extremely rapid rate. Our database and technologies may not be able to keep pace with the growth in the number of websites, especially the growing amount of content utilizing foreign languages and the increasing sophistication of malicious code and the delivery mechanisms associated with spyware, phishing and other hazards associated with the internet. Further, the ongoing evolution of the internet and computing environments will require us to continually improve the functionality, features and reliability of our web filtering function. Any failure of our databases to keep pace with the rapid growth and technological change of the internet could impair the market acceptance of our products, which in turn could harm our business, financial condition and results of operations.

In addition, our web filtering service may not be successful in accurately categorizing internet and application content to meet our end-customers' expectations. We rely upon a combination of automated filtering technology and human review to categorize websites and software applications in our proprietary databases. Our end-customers may not agree with our determinations that particular URLs should be included or not included in specific categories of our databases. In addition, it is possible that our filtering processes may place material that is objectionable or that presents a security risk in categories that are generally unrestricted by our customers' internet and computer access policies, which could result in such material not being blocked from the network. Conversely, we may miscategorize websites such that access is denied to websites containing information that is important or valuable to our customers. Any miscategorization could result in customer dissatisfaction and harm our reputation. Any failure to effectively categorize and filter websites according to our end-customers' and channel partners' expectations could impair the growth of our business.

If our new products and product enhancements do not achieve sufficient market acceptance, our results of operations and competitive position will suffer.

We spend substantial amounts of time and money to acquire and develop internally new products and enhanced versions of our existing products in order to incorporate additional features, improved functionality or other enhancements in order to meet our customers' rapidly evolving demands for network security in our highly competitive industry. When we develop a new product or an enhanced version of an existing product, we typically incur expenses and expend resources upfront to market, promote and sell the new offering. Therefore, when we develop and introduce new or enhanced products, they must achieve high levels of market acceptance in order to justify the amount of our investment in developing and bringing them to market.

Our new products or product enhancements could fail to attain sufficient market acceptance for many reasons, including:

- delays in releasing our new products or enhancements to the market;
- failure to accurately predict market demand in terms of product functionality and to supply products that meet this demand in a timely fashion;
- failure to have the appropriate research and development expertise and focus to make our top strategic fabric products successful;
- failure of our sales force and partners to focus on selling new products;
- inability to interoperate effectively with the networks or applications of our prospective end-customers;
- inability to protect against new types of attacks or techniques used by hackers;
- actual or perceived defects, vulnerabilities, errors or failures;
- negative publicity about their performance or effectiveness;
- introduction or anticipated introduction of competing products by our competitors;
- poor business conditions for our end-customers, causing them to delay IT purchases;
- changes to the regulatory requirements around security; and
- reluctance of customers to purchase products incorporating open source software.

If our new products or enhancements do not achieve adequate acceptance in the market, our competitive position will be impaired, our revenue will be diminished and the effect on our operating results may be particularly acute because of the significant research, development, marketing, sales and other expenses we incurred in connection with the new product or enhancement.

Demand for our products may be limited by market perception that individual products from one vendor that provide multiple layers of security protection in one product are inferior to point solution network security solutions from multiple vendors.

Sales of many of our products depend on increased demand for incorporating broad security functionality into one appliance. If the market for these products fails to grow as we anticipate, our business will be seriously harmed. Target customers may view “all-in-one” network security solutions as inferior to security solutions from multiple vendors because of, among other things, their perception that such products of ours provide security functions from only a single vendor and do not allow users to choose “best-of-breed” defenses from among the wide range of dedicated security applications available. Target customers might also perceive that, by combining multiple security functions into a single platform, our solutions create a “single point of failure” in their networks, which means that an error, vulnerability or failure of our product may place the entire network at risk. In addition, the market perception that “all-in-one” solutions may be suitable only for small and medium-sized businesses because such solution lacks the performance capabilities and functionality of other solutions may harm our sales to large businesses, service provider and government organization end-customers. If the foregoing concerns and perceptions become prevalent, even if there is no factual basis for these concerns and perceptions, or if other issues arise with our market in general, demand for multi-security functionality products could be severely limited, which would limit our growth and harm our business, financial condition and results of operations. Further, a successful and publicized targeted attack against us, exposing a “single point of failure,” could significantly increase these concerns and perceptions and may harm our business and results of operations.

We face intense competition in our market and we may lack sufficient financial or other resources to maintain or improve our competitive position.

The market for network security products is intensely competitive and we expect competition to intensify in the future. We face many competitors across the different cybersecurity markets. Our competitors include companies such as Barracuda, Check Point, Cisco, CrowdStrike, F5 Networks, FireEye, Forcepoint, Imperva, Juniper, McAfee, Palo Alto Networks, Proofpoint, SonicWALL, Sophos, Trend Micro and Zscaler.

Many of our existing and potential competitors enjoy substantial competitive advantages such as:

- greater name recognition and longer operating histories;
- larger sales and marketing budgets and resources;
- broader distribution and established relationships with distribution partners and end-customers;
- access to larger customer bases;
- greater customer support resources;
- greater resources to make acquisitions;
- lower labor and development costs; and
- substantially greater financial, technical and other resources.

In addition, some of our larger competitors have substantially broader product offerings, and leverage their relationships based on other products or incorporate functionality into existing products in a manner that discourages customers from purchasing our products. These larger competitors often have broader product lines and market focus, and are in a better position to withstand any significant reduction in capital spending by end-customers in these markets. Therefore, these competitors will not be as susceptible to downturns in a particular market. Also, many of our smaller competitors that specialize in providing protection from a single type of security threat are often able to deliver these specialized security products to the market more quickly than we can.

Conditions in our markets could change rapidly and significantly as a result of technological advancements or continuing market consolidation. Our competitors and potential competitors may also be able to develop products or services, and leverage new business models, that are equal or superior to ours, achieve greater market acceptance of their products and services, and increase sales by utilizing different distribution channels than we do. For example, certain of our competitors are focusing on delivering security services from the cloud. In addition, current or potential competitors may be acquired by third

parties with greater available resources, and new competitors may arise pursuant to acquisitions of network security companies or divisions. As a result of such acquisitions, competition in our market may continue to increase and our current or potential competitors might be able to adapt more quickly to new technologies and customer needs, devote greater resources to the promotion or sale of their products and services, initiate or withstand substantial price competition, take advantage of acquisition or other opportunities more readily, or develop and expand their product and service offerings more quickly than we do. In addition, our competitors may bundle products and services competitive with ours with other products and services. Customers may accept these bundled products and services rather than separately purchasing our products and services. As our customers refresh the security products bought in prior years, they may seek to consolidate vendors, which may result in current customers choosing to purchase products from our competitors on an ongoing basis. Due to budget constraints or economic downturns, organizations may be more willing to incrementally add solutions to their existing network security infrastructure from competitors than to replace it with our solutions. These competitive pressures in our market or our failure to compete effectively may result in price reductions, fewer customer orders, reduced revenue and gross margins and loss of market share.

If functionality similar to that offered by our products is incorporated into existing network infrastructure products, organizations may decide against adding our appliances to their network, which would have an adverse effect on our business.

Large, well-established providers of networking equipment such as Cisco, F5 Networks and Juniper offer, and may continue to introduce, network security features that compete with our products, either in standalone security products or as additional features in their network infrastructure products. The inclusion of, or the announcement of an intent to include, functionality perceived to be similar to that offered by our security solutions in networking products that are already generally accepted as necessary components of network architecture may have an adverse effect on our ability to market and sell our products. Furthermore, even if the functionality offered by network infrastructure providers is more limited than our products, a significant number of customers may elect to accept such limited functionality in lieu of adding appliances from an additional vendor such as us. Many organizations have invested substantial personnel and financial resources to design and operate their networks and have established deep relationships with other providers of networking products, which may make them reluctant to add new components to their networks, particularly from other vendors such as us. In addition, an organization's existing vendors or new vendors with a broad product offering may be able to offer concessions that we are not able to match because we currently offer only network security products and have fewer resources than many of our competitors. If organizations are reluctant to add additional network infrastructure from new vendors or otherwise decide to work with their existing vendors, our business, financial condition and results of operations will be adversely affected.

Risks Related to Intellectual Property

Our proprietary rights may be difficult to enforce, which could enable others to copy or use aspects of our products without compensating us.

We rely primarily on patent, trademark, copyright and trade secrets laws and confidentiality procedures and contractual provisions to protect our technology. Valid patents may not issue from our pending applications, and the claims eventually allowed on any patents may not be sufficiently broad to protect our technology or products. Any issued patents may be challenged, invalidated or circumvented, and any rights granted under these patents may not actually provide adequate defensive protection or competitive advantages to us. Patent applications in the United States are typically not published until at least 18 months after filing, or, in some cases, not at all, and publications of discoveries in industry-related literature lag behind actual discoveries. We cannot be certain that we were the first to make the inventions claimed in our pending patent applications or that we were the first to file for patent protection. Additionally, the process of obtaining patent protection is expensive and time-consuming, and we may not be able to prosecute all necessary or desirable patent applications at a reasonable cost or in a timely manner. In addition, recent changes to the patent laws in the United States may bring into question the validity of certain software patents and may make it more difficult and costly to prosecute patent applications. As a result, we may not be able to obtain adequate patent protection or effectively enforce our issued patents.

Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or obtain and use information that we regard as proprietary. We generally enter into confidentiality or license agreements with our employees, consultants, vendors and customers, and generally limit access to and distribution of our proprietary information. However, we cannot guarantee that the steps taken by us will prevent misappropriation of our technology. Policing unauthorized use of our technology or products is difficult. In addition, the laws of some foreign countries do not protect our proprietary rights to as great an extent as the laws of the United States, and many foreign countries do not enforce these laws as diligently as government agencies and private parties in the United States. From time to time, legal action by us may be necessary to enforce our patents and other IP rights, to protect our trade secrets, to determine the validity and scope of the

proprietary rights of others or to defend against claims of infringement or invalidity. Such litigation could result in substantial costs and diversion of resources and could negatively affect our business, operating results and financial condition. If we are unable to protect our proprietary rights (including aspects of our software and products protected other than by patent rights), we may find ourselves at a competitive disadvantage to others who need not incur the additional expense, time and effort required to create the innovative products that have enabled us to be successful to date.

Our products contain third-party open source software components, and failure to comply with the terms of the underlying open source software licenses could restrict our ability to sell our products.

Our products contain software modules licensed to us by third-party authors under “open source” licenses, including the GNU Public License, the GNU Lesser Public License, the BSD License, the Apache License, the MIT X License and the Mozilla Public License. From time to time, there have been claims against companies that distribute or use open source software in their products and services, asserting that open source software infringes the claimants’ IP rights. We could be subject to suits by parties claiming infringement of IP rights in what we believe to be licensed open source software. Use and distribution of open source software may entail greater risks than use of third-party commercial software, as, for example, open source licensors generally do not provide warranties or other contractual protections regarding infringement claims or the quality of the code. Some open source licenses contain requirements that we make available source code for modifications or derivative works we create based upon the type of open source software we use. If we combine our proprietary software with open source software in a certain manner, we could, under certain open source licenses, be required to release the source code of our proprietary software to the public. This would allow our competitors to create similar products with lower development effort and time and ultimately could result in a loss of product sales for us.

Although we monitor our use of open source software to avoid subjecting our products to conditions we do not intend, the terms of many open source licenses have not been interpreted by U.S. courts, and there is a risk that these licenses could be construed in a way that, for example, could impose unanticipated conditions or restrictions on our ability to commercialize our products. In this event, we could be required to seek licenses from third parties to continue offering our products, to make our proprietary code generally available in source code form, to re-engineer our products or to discontinue the sale of our products if re-engineering could not be accomplished on a timely basis, any of which requirements could adversely affect our business, operating results and financial condition.

Claims by others that we infringe their proprietary technology or other litigation matters could harm our business.

Patent and other IP disputes are common in the network security industry. Third parties are currently asserting, have asserted and may in the future assert claims of infringement of IP rights against us. Third parties have also asserted such claims against our end-customers or channel partners whom we may indemnify against claims that our products infringe the IP rights of third parties. As the number of products and competitors in our market increases and overlaps occur, infringement claims may increase. Any claim of infringement by a third party, even those without merit, could cause us to incur substantial costs defending against the claim and could distract our management from our business. In addition, litigation may involve patent holding companies, non-practicing entities or other adverse patent owners who have no relevant product revenue and against whom our own patents may therefore provide little or no deterrence or protection.

Although third parties may offer a license to their technology, the terms of any offered license may not be acceptable, and the failure to obtain a license or the costs associated with any license could cause our business, financial condition and results of operations to be materially and adversely affected. In addition, some licenses may be non-exclusive and, therefore, our competitors may have access to the same technology licensed to us.

Alternatively, we may be required to develop non-infringing technology, which could require significant time, effort and expense, and may ultimately not be successful. Furthermore, a successful claimant could secure a judgment or we may agree to a settlement that prevents us from distributing certain products or performing certain services or that requires us to pay substantial damages (including treble damages if we are found to have willfully infringed such claimant’s patents or copyrights), royalties or other fees. Any of these events could seriously harm our business, financial condition and results of operations.

From time to time we are subject to lawsuits claiming patent infringement. We are also subject to other litigation in addition to patent infringement claims, such as employment-related litigation and disputes, as well as general commercial litigation, and could become subject to other forms of litigation and disputes, including stockholder litigation. If we are unsuccessful in defending any such claims, our operating results and financial condition and results may be materially and adversely affected. For example, we may be required to pay substantial damages and could be prevented from selling certain of our products. Litigation, with or without merit, could negatively impact our business, reputation and sales in a material fashion.

We have several ongoing patent lawsuits, certain companies have sent us demand letters proposing that we license certain of their patents, and organizations have sent letters demanding that we provide indemnification for patent claims. As two examples of the ongoing patent lawsuits against us, one such patent lawsuit by British Telecommunications plc was filed in federal court in Delaware in July 2018, and a second such lawsuit by Finjan, Inc. was filed in federal court in California in October 2018, and additional patent lawsuits have been filed against us since. Given this and the proliferation of lawsuits in our industry and other similar industries by both non-practicing entities and operating entities, and recent non-practicing entity and operating entity patent litigation against other companies in the security space, we expect that we will be sued for patent infringement in the future, regardless of the merits of any such lawsuits. The cost to defend such lawsuits and any settlement payment or adverse result in such lawsuits could have a material adverse effect on our results of operations and financial condition.

We rely on the availability of third-party licenses.

Many of our products include software or other IP licensed from third parties. It may be necessary in the future to renew licenses relating to various aspects of these products or to seek new licenses for existing or new products. Licensors may claim we owe them additional license fees for past and future use of their software and other IP or that we cannot utilize such software or IP in our products going forward. There can be no assurance that the necessary licenses would be available on acceptable terms, if at all. The inability to obtain certain licenses or other rights or to obtain such licenses or rights on favorable terms or for reasonable pricing, or the need to engage in litigation regarding these matters, could result in delays in product releases until equivalent technology can be identified, licensed or developed, if at all, and integrated into our products and may result in significant license fees and have a material adverse effect on our business, operating results, and financial condition. Moreover, the inclusion in our products of software or other IP licensed from third parties on a non-exclusive basis could limit our ability to differentiate our products from those of our competitors.

We also rely on technologies licensed from third parties in order to operate functions of our business. If any of these third parties allege that we have not properly paid for such licenses or that we have improperly used the technologies under such licenses, we may need to pay additional fees or obtain new licenses, and such licenses may not be available on terms acceptable to us or at all or may be costly. In any such case, or if we were required to redesign our internal operations to function with new technologies, our business, results of operations and financial condition could be harmed.

Risks Related to Ownership of our Common Stock

As a public company, we are subject to compliance initiatives that will require substantial time from our management and result in significantly increased costs that may adversely affect our operating results and financial condition.

The Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”), Dodd-Frank and other rules implemented by the SEC and The Nasdaq Stock Market impose various requirements on public companies, including requiring changes in corporate governance practices. These requirements, as well as proposed corporate governance laws and regulations under consideration, may further increase our compliance costs. If compliance with these various legal and regulatory requirements diverts our management’s attention from other business concerns, it could have a material adverse effect on our business, financial condition and results of operations. Sarbanes-Oxley requires, among other things, that we assess the effectiveness of our internal control over financial reporting annually, and of our disclosure controls and procedures quarterly. Although our most recent assessment, testing and evaluation resulted in our conclusion that, as of December 31, 2019, our internal controls over financial reporting were effective, we cannot predict the outcome of our testing in 2020 or future periods. We may incur additional expenses and commitment of management’s time in connection with further evaluations, both of which could materially increase our operating expenses and accordingly reduce our operating results.

Changes in financial accounting standards may cause adverse unexpected fluctuations and affect our reported results of operations.

A change in accounting standards or practices, and varying interpretations of existing or new accounting pronouncements, such as changes to standards related to accounting for leases (which became effective for us on January 1, 2019), as well as the significant costs incurred or that may be incurred to adopt and to comply with these new pronouncements, could have a significant effect on our reported financial results or the way we conduct our business. If we do not ensure that our systems and processes are aligned with the new standards, we could encounter difficulties generating quarterly and annual financial statements in a timely manner, which could have an adverse effect on our business, our ability to meet our reporting obligations and compliance with internal control requirements.

The lease standard is principles based and interpretation of those principles may vary from company to company based on their unique circumstances. Management will continue to make judgments and assumptions based on our interpretation of the new standard. If our circumstances change or if actual circumstances differ from our assumptions, our operating result may be adversely affected and could fall below our publicly announced guidance or the expectations of securities analysts and investors, resulting in a decline in the market price of our common stock. Further, equity investments are now required to be measured at fair value (with subsequent changes in fair value recognized in net income), which may increase the volatility of our earnings

If securities or industry analysts stop publishing research or publish inaccurate or unfavorable research about our business, our stock price and trading volume could decline.

The trading market for our common stock will depend in part on the research and reports that securities or industry analysts publish about us or our business. If we do not maintain adequate research coverage or if one or more of the analysts who cover us downgrades our stock or publishes inaccurate or unfavorable research about our business, our stock price could decline. If one or more of these analysts ceases coverage of our company or fails to publish reports on us regularly, demand for our stock could decrease, which could cause our stock price and trading volume to decline.

The trading price of our common stock may be volatile.

The market price of our common stock may be subject to wide fluctuations in response to, among other things, the risk factors described in this periodic report, news about us and our financial results, the impact of the COVID-19 pandemic, news about our competitors and their results, and other factors such as rumors or fluctuations in the valuation of companies perceived by investors to be comparable to us. For example, the three months ended March 31, 2020, the closing price of our common stock ranged from \$75.70 to \$121.33 per share.

Furthermore, stock markets have experienced price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many companies. These fluctuations often have been unrelated or disproportionate to the operating performance of those companies. These broad market and industry fluctuations, as well as general economic, political and market conditions, such as recessions, interest rate changes or international currency fluctuations, may negatively affect the market price of our common stock.

In the past, many companies that have experienced volatility in the market price of their stock have been subject to securities class action litigation. We may be the target of this type of litigation in the future. Securities litigation against us could result in substantial costs and divert our management's attention from other business concerns, which could seriously harm our business. In addition, the market price of our common stock and the market price of the common stock of many other companies have fallen significantly since the outbreak of the COVID-19 pandemic. The extent to which the COVID-19 pandemic may impact the market price of our common stock is unclear, and the market price of our common stock may fluctuate significantly as a result of the COVID-19 pandemic.

Share repurchases under our Repurchase Program (the "Repurchase Program") could increase the volatility of the trading price of our common stock, could diminish our cash reserves, could occur at non-optimal prices and may not result in the most effective use of our capital.

In November 2019, our board of directors approved a \$1.0 billion increase in the authorized stock repurchase under the Repurchase Program and extended the term of the Repurchase Program to February 28, 2021, bringing the aggregate amount authorized to be repurchased \$2.5 billion. As of March 31, 2020, \$0.7 billion remained available for future share repurchases under the Repurchase Program. Share repurchases under the Repurchase Program could affect the price of our common stock, increase stock price volatility and diminish our cash reserves. In addition, an announcement of the reduction, suspension or termination of the Repurchase Program could result in a decrease in the trading price of our common stock. Moreover, our stock price could decline, resulting in repurchases made at non-optimal prices. Our failure to repurchase our stock at optimal prices may be perceived by investors as an inefficient use of our cash and cash equivalents, which could result in litigation that may have an adverse effect on our business, operating results and financial condition. In addition, while our board of directors carefully considers various alternative uses of our cash and cash equivalents in determining whether to authorize stock repurchases, there can be no assurance that the decision by our board of directors to repurchase stock would result in the most effective uses of our cash and cash equivalents, and there may be alternative uses of our cash and cash equivalents that would be more effective, such as investing in growing our business organically or through acquisitions.

Anti-takeover provisions contained in our certificate of incorporation and bylaws, as well as provisions of Delaware law, could impair a takeover attempt.

Our certificate of incorporation, bylaws and Delaware law contain provisions that could have the effect of rendering more difficult, delaying or preventing an acquisition deemed undesirable by our board of directors. Our corporate governance documents include provisions:

- authorizing “blank check” preferred stock, which could be issued by the board without stockholder approval and may contain voting, liquidation, dividend and other rights superior to our common stock;
- limiting the liability of, and providing indemnification to, our directors and officers;
- limiting the ability of our stockholders to call and bring business before special meetings;
- requiring advance notice of stockholder proposals for business to be conducted at meetings of our stockholders and for nominations of candidates for election to our board of directors;
- providing that certain litigation matters may only be brought against us in state or federal courts in the State of Delaware;
- controlling the procedures for the conduct and scheduling of board and stockholder meetings; and
- providing the board of directors with the express power to postpone previously scheduled annual meetings and to cancel previously scheduled special meetings.

These provisions, alone or together, could delay or prevent hostile takeovers and changes in control or changes in our management.

In addition, our amended and restated bylaws provide that unless we consent in writing to the selection of an alternative forum, to the fullest extent permitted by law, the federal district courts of the United States shall be the exclusive forum for the resolution of any complaint asserting a cause of action arising under the Securities Act of 1933, as amended. Any person or entity purchasing or otherwise acquiring any interest in any of our securities shall be deemed to have notice of and consented to this provision. This provision, as well as provisions providing that certain litigation matters may only be brought against us in state or federal courts in the State of Delaware, may limit a stockholder’s ability to bring a claim in a judicial forum that it finds favorable for disputes with us or any of our directors, officers or other employees, which may discourage lawsuits against us and our directors, officers and other employees.

As a Delaware corporation, we are also subject to provisions of Delaware law, including Section 203 of the Delaware General Corporation Law, which prevents stockholders holding more than 15% of our outstanding common stock from engaging in certain business combinations without approval of the holders of a substantial majority of all of our outstanding common stock.

Any provision of our certificate of incorporation, bylaws or Delaware law that has the effect of delaying or deterring a change in control could limit the opportunity for our stockholders to receive a premium for their shares of our common stock, and could also affect the price that some investors are willing to pay for our common stock.

However, these anti-takeover provisions will not have the effect of preventing activist stockholders from seeking to increase short-term stockholder value through actions such as nominating board candidates and requesting that we pursue strategic combinations or other transactions. These actions could disrupt our operations, be costly and time-consuming and divert the attention of our management and employees. In addition, perceived uncertainties as to our future direction as a result of activist stockholder actions could result in the loss of potential business opportunities, as well as other negative business consequences. Actions of an activist stockholder may also cause fluctuations in our stock price based on speculative market perceptions or other factors that do not necessarily reflect our business. Further, we may incur significant expenses in retaining professionals to advise and assist us on activist stockholder matters, including legal, financial, communications advisors and solicitation experts, which may negatively impact our future financial results.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds***Purchases of Equity Securities by the Issuer and Affiliated Purchasers******Share Repurchase Program***

The following table provides information with respect to the shares of common stock we repurchased under the Repurchase Program during the three months ended March 31, 2020 (in millions, except per share amounts):

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan or Program	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
January 1 - January 31, 2020	—	\$ —	—	\$ 1,592.8
February 1 - February 29, 2020	0.4	\$ 103.36	0.4	\$ 1,550.9
March 1 - March 31, 2020	9.6	\$ 89.80	9.6	\$ 692.9
Total	10.0	\$ 90.36	10.0	

ITEM 6. Exhibits

The exhibits listed in the accompanying Exhibit Index are filed or incorporated by reference as part of this Quarterly Report on Form 10-Q.

EXHIBIT INDEX

		Incorporated by reference herein		
		Form	Date	Exhibit Number
3.1	Amended and Restated Bylaws	Current Report on Form 8-K (File No. 001-34511)	April 23, 2020	3.1
31.1*	Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002			
31.2*	Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002			
32.1#	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002			
101.INS*	Inline XBRL Instance Document - the instance document does not appear in the interactive data file because its XBRL tags are embedded within the inline XBRL document.			
101.SCH*	Inline XBRL Taxonomy Extension Schema Document			
101.CAL*	Inline XBRL Taxonomy Extension Calculation Linkbase Document			
101.DEF*	Inline XBRL Taxonomy Extension Definition Linkbase Document			
101.LAB*	Inline XBRL Taxonomy Extension Label Linkbase Document			
101.PRE*	Inline XBRL Taxonomy Extension Presentation Linkbase Document			
104*	Cover Page Interactive Data File - the cover page from the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2020 is formatted in inline XBRL.			

* Filed herewith.

Furnished herewith.

SIGNATURES

Pursuant to the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: May 6, 2020

FORTINET, INC.

By: _____ /s/ Ken Xie
Ken Xie, Chief Executive Officer and Chairman
(Duly Authorized Officer and Principal Executive Officer)

FORTINET, INC.

By: _____ /s/ Keith Jensen
Keith Jensen, Chief Financial Officer
(Duly Authorized Officer and Principal Financial Officer and Principal Accounting Officer)

CERTIFICATION

I, Ken Xie, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Fortinet, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 6, 2020

/s/ Ken Xie

Ken Xie

Chief Executive Officer and Chairman
(Principal Executive Officer)

CERTIFICATION

I, Keith Jensen, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Fortinet, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 6, 2020

/s/ Keith Jensen

Keith Jensen

Chief Financial Officer

(Principal Financial Officer and Principal Accounting Officer)

CERTIFICATIONS OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER**PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Ken Xie, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q of Fortinet, Inc. for the quarter ended March 31, 2020 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and that information contained in this Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Fortinet, Inc.

Date: May 6, 2020

By: /s/ Ken Xie

Name: Ken Xie

Title: Chief Executive Officer and Chairman
(Principal Executive Officer)

I, Keith Jensen, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q of Fortinet, Inc. for the quarter ended March 31, 2020 fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act and that information contained in this Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Fortinet, Inc.

Date: May 6, 2020

By: /s/ Keith Jensen

Name: Keith Jensen

Title: Chief Financial Officer
(Principal Financial Officer and Principal Accounting Officer)

This certification is being furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and will not be deemed "filed" for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section. This certification will not be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act, except as shall be expressly set forth by specific reference in such a filing.