

**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

**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: 0-17995



**ZIX CORPORATION**

(Exact Name of Registrant as Specified in its Charter)

Texas  
(State of Incorporation)

75-2216818  
(I.R.S. Employer Identification Number)

2711 North Haskell Avenue  
Suite 2200, LB 36  
Dallas, Texas 75204-2960  
(Address of Principal Executive Offices)

(214) 370-2000  
(Registrant's Telephone Number, Including Area Code)

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 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, 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	<input type="checkbox"/>	Accelerated filer	<input checked="" type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
Emerging growth company	<input type="checkbox"/>		

If an emerging growth company, indicated 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 Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class  
**Common Stock, par value \$0.01 per share**

Outstanding at May 5, 2020  
**56,925,946**

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

Title of Each Class	Trading Symbol(s)	Name of Exchange on Which Registered
Common Stock, par value \$0.01 per share	ZIXI	NASDAQ Global Market

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**ZIX CORPORATION**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

(In thousands, except share and par value data)

	March 31, 2020 (unaudited)	December 31, 2019
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 16,295	\$ 13,349
Receivables, net	13,037	10,081
Prepaid and other current assets	4,796	4,984
Total current assets	34,128	28,414
Property and equipment, net	8,368	8,591
Operating lease assets	9,709	10,128
Intangible assets, net	142,993	145,876
Goodwill	170,377	171,209
Deferred tax assets	37,423	36,535
Deferred costs and other assets	12,302	11,968
Total assets	<u>\$ 415,300</u>	<u>\$ 412,721</u>
<b>LIABILITIES, PREFERRED STOCK AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 14,954	\$ 14,400
Accrued expenses	11,164	13,732
Deferred revenue	42,417	40,757
Current portion of long-term debt	1,850	1,850
Operating lease liabilities, current	2,690	2,947
Finance lease liabilities, current	1,134	1,338
Total current liabilities	74,209	75,024
Long-term liabilities:		
Deferred revenue	1,994	2,524
Noncurrent operating lease liabilities	8,197	8,389
Noncurrent finance lease liabilities	515	716
Long-term debt	184,107	178,250
Total long-term liabilities	194,813	189,879
Total liabilities	269,022	264,903
Commitments and contingencies (see Note 11)		
Preferred stock:		
Series A convertible preferred stock, \$1 par value; 100,206 shares designated, issued and outstanding in 2020 and in 2019	108,756	106,527
Total preferred stock	108,756	106,527
Stockholders' equity:		
Preferred stock, \$1 par value, 10,000,000 shares authorized; none issued and outstanding	—	—
Common stock, \$0.01 par value, 175,000,000 shares authorized; 84,953,964 issued and 56,962,705 outstanding in 2020 and 83,393,514 issued and 55,640,397 outstanding in 2019	781	780
Additional paid-in capital	393,710	391,605
Treasury stock, at cost; 27,991,259 common shares in 2020 and 27,753,117 common shares in 2019	(112,083)	(110,298)
Accumulated deficit	(244,180)	(240,995)
Accumulated other comprehensive income (loss)	(706)	199
Total stockholders' equity	37,522	41,291
Total liabilities, preferred stock and stockholders' equity	<u>\$ 415,300</u>	<u>\$ 412,721</u>

See notes to condensed consolidated financial statements.

**ZIX CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**  
(Unaudited)

(In thousands, except share and per share data)	Three Months Ended March 31,	
	2020	2019
Revenue	\$ 52,434	\$ 29,300
Cost of revenue	26,079	11,139
Gross margin	26,355	18,161
Operating expenses:		
Research and development	5,386	4,147
Selling, general and administrative	20,029	20,264
Total operating expenses	25,415	24,411
Operating income (loss)	940	(6,250)
Other income (expense):		
Investment and other income (expense)	(15)	92
Interest expense	(2,648)	(1,255)
Total other (expense) income	(2,663)	(1,163)
Loss before income taxes	(1,723)	(7,413)
Income tax benefit	870	1,148
Net loss	<u>\$ (853)</u>	<u>\$ (6,265)</u>
Deemed and accrued dividends on preferred stock	2,229	2,433
Net loss attributable to common stockholders	<u>\$ (3,082)</u>	<u>\$ (8,698)</u>
Basic loss per share attributable to common stockholders	<u>\$ (0.06)</u>	<u>\$ (0.17)</u>
Diluted loss per common share attributable to common stockholders	<u>\$ (0.06)</u>	<u>\$ (0.17)</u>
Basic weighted average common shares outstanding	53,496,042	52,713,576
Diluted weighted average common shares outstanding	53,496,042	52,713,576
Other comprehensive loss, net of tax		
Foreign currency translation adjustments	(905)	(32)
Comprehensive loss	<u>\$ (1,758)</u>	<u>\$ (6,297)</u>

See notes to condensed consolidated financial statements

**ZIX CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENT OF PREFERRED STOCK AND STOCKHOLDERS' EQUITY**  
(Unaudited)

	Preferred Stock and Stockholders' Equity								
	Preferred Stock		Common Stock		Additional Paid-In Capital	Treasury Stock	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
(In thousands, except shares)	Shares	Amount	Shares	Amount					
Balances, December 31, 2019, as reported	100,206	\$ 106,257	83,393,514	\$ 780	\$ 391,605	\$(110,298)	\$(240,995)	\$ 199	\$ 41,291
Cumulative effect adjustment from changes in accounting standard (Note 2)	—	—	—	—	—	—	(103)	—	(103)
Balance, January 01, 2020	100,206	106,257	83,393,514	780	391,605	(110,298)	(241,098)	199	41,188
Accretion of beneficial conversion feature of Series A Preferred Shares (Participating)	—	48	—	—	—	—	(48)	—	(48)
Accrued dividend on Series A preferred stock	—	2,181	—	—	—	—	(2,181)	—	(2,181)
Net issuance of common stock upon exercise of stock options	—	—	46,875	1	116	—	—	—	117
Net issuance of common stock upon vesting of restricted stock units	—	—	30,084	—	—	—	—	—	—
Net issuance of common stock upon vesting of performance stock units	—	—	16,062	—	—	—	—	—	—
Net issuance of restricted common stock	—	—	1,062,983	—	—	—	—	—	—
Net issuance of restricted performance common stock	—	—	404,746	—	—	—	—	—	—
Employee stock-based compensation costs	—	—	—	—	1,989	(1,785)	—	—	204
Adjustment from foreign currency translation	—	—	—	—	—	—	—	(905)	(905)
Net loss	—	—	—	—	—	—	(853)	—	(853)
Balances, March 31, 2020	<u>100,206</u>	<u>\$ 108,486</u>	<u>84,954,264</u>	<u>\$ 781</u>	<u>\$ 393,710</u>	<u>\$(112,083)</u>	<u>\$(244,180)</u>	<u>\$ (706)</u>	<u>\$ 37,522</u>

See notes to condensed consolidated financial statements.

**ZIX CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENT OF PREFERRED STOCK AND STOCKHOLDERS' EQUITY**  
(Unaudited)

Continued

	Preferred Stock and Stockholders' Equity								
	Preferred Stock		Common Stock		Additional Paid-In Capital	Treasury Stock	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
(In thousands, except shares)	Shares	Amount	Shares	Amount					
Balances, December 31, 2018, as reported	—	\$ —	81,715,330	\$ 779	\$ 384,940	\$(108,392)	\$ (216,364)	\$ (16)	\$ 60,947
Issuance of Series A preferred stock in connection with private placement, net of issuance costs of \$2,253	64,914	62,662	—	—	—	—	—	—	—
Issuance of Series B preferred stock in connection with private placement, net of issuance costs of \$1,204	35,086	33,881	—	—	—	—	—	—	—
Beneficial conversion feature of Series A preferred stock	—	1,407	—	—	—	—	(1,407)	—	(1,407)
Accretion of beneficial conversion feature of Series A Preferred Shares (Participating)	—	12	—	—	—	—	(12)	—	(12)
Accrued dividend on Series A preferred stock	—	563	—	—	—	—	(563)	—	(563)
Accrued dividend on Series B preferred stock	—	380	—	—	—	—	(380)	—	(380)
Redemption Accretion of Series B preferred stock	—	71	—	—	—	—	(71)	—	(71)
Net issuance of common stock upon exercise of stock options	—	—	17,438	—	36	—	—	—	36
Net issuance of common stock upon vesting of restricted stock units	—	—	40,334	—	—	—	—	—	—
Net issuance of common stock upon vesting of performance stock units	—	—	392,500	—	—	—	—	—	—
Net issuance of restricted common stock	—	—	1,116,724	—	—	—	—	—	—
Net issuance of restricted performance common stock	—	—	5,777	—	—	—	—	—	—
Employee stock-based compensation costs	—	—	—	—	1,229	(1,340)	—	—	(111)
Adjustment from foreign currency translation	—	—	—	—	—	—	—	(32)	(32)
Net loss	—	—	—	—	—	—	(6,265)	—	(6,265)
<b>Balances, March 31, 2019</b>	<b>100,000</b>	<b>\$ 98,976</b>	<b>83,288,103</b>	<b>\$ 779</b>	<b>\$ 386,205</b>	<b>\$(109,732)</b>	<b>\$ (225,062)</b>	<b>\$ (48)</b>	<b>\$ 52,142</b>

See notes to condensed consolidated financial statements.

**ZIX CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)

(In thousands)	<b>Three Months Ended March 31,</b>	
	<b>2020</b>	<b>2019</b>
<b>Operating activities:</b>		
Net loss	\$ (853)	\$ (6,265)
<b>Non-cash items in net loss:</b>		
Depreciation and amortization	7,792	2,696
Amortization of debt issuance costs	320	116
Employee stock-based compensation costs	1,991	1,229
Noncash lease costs	782	(4,385)
Changes in deferred taxes	(887)	(1,103)
<b>Changes in operating assets and liabilities:</b>		
Receivables	(2,947)	(113)
Prepaid and other current assets	179	(1,004)
Deferred costs and other assets	(330)	(856)
Accounts payable	562	5,989
Deferred revenue	1,135	(212)
Earn-out payment	—	(385)
Accrued and other liabilities	(3,337)	3,876
Net cash provided by (used in) operating activities	4,407	(417)
<b>Investing activities:</b>		
Purchases of property, equipment and internal-use software	(5,007)	(1,742)
Acquisition of business, net of cash acquired	—	(271,706)
Net cash used in investing activities	(5,007)	(273,448)
<b>Financing activities:</b>		
Proceeds of long-term debt	6,000	175,000
Debt issuance cost	—	(6,389)
Proceeds from issuance of Series A preferred stock, net of offering costs	—	62,692
Proceeds from issuance of Series B preferred stock, net of offering costs	—	33,896
Proceeds from exercise of stock options	117	36
Repayment of long-term debt	(460)	—
Repayment of finance lease liabilities	(406)	—
Purchase of treasury shares	(1,785)	(1,340)
Earn-out payment	—	(415)
Net cash provided by financing activities	3,466	263,480
Effect of exchange rate on cash	80	(33)
Increase (decrease) in cash and cash equivalents	2,946	(10,418)
Cash and cash equivalents, beginning of period	13,349	27,109
Cash and cash equivalents, end of period	<u>\$ 16,295</u>	<u>\$ 16,691</u>

See notes to condensed consolidated financial statements.

**ZIX CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
(Unaudited)

**1. Basis of Presentation**

The accompanying condensed consolidated financial statements of Zix Corporation (“Zix” the “Company,” “we,” “our” or “us”) should be read in conjunction with the audited consolidated financial statements included in the Company’s 2019 Annual Report on Form 10-K. These financial statements are unaudited, but have been prepared in the ordinary course of business for the purpose of providing information with respect to the covered interim periods.

Management of the Company believes that all adjustments necessary for a fair presentation for such periods have been included and are of a normal recurring nature. The results of operations for the three-month period ended March 31, 2020, are not necessarily indicative of the results to be expected for any future periods or for the full fiscal year. The preparation of financial

statements and related disclosures in accordance with accounting principles generally accepted in the United States requires the Company’s management to make estimates and assumptions that affect reported amounts and disclosures. These estimates and assumptions take into account historical and forward looking factors that the Company believes are reasonable, including but not limited to the potential impacts arising from the recent coronavirus (COVID-19) and public and private sector policies and initiatives aimed at reducing its transmission. As the extent and duration of the impacts of the COVID-19 remain unclear, the Company’s estimates and assumptions may evolve as conditions change. Actual results could differ significantly from those estimates.

**2. Recent Accounting Standards and Pronouncements**

*Credit Losses*

On January 1, 2020, we adopted Accounting Standard Update No. 2016-13, Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments with a net increase of our receivables allowance and a related cumulative adjustment to our retained earnings recorded at the beginning of adoption. Upon adoption, we changed our impairment model to utilize a forward-looking current expected credit losses (CECL) model in place of the incurred loss impairment model for our accounting receivable balance. The cumulative effect adjustment from adoption was immaterial to our condensed consolidated financial statements.

*Intangibles – Goodwill and Other*

In January 2017, the FASB issued Accounting Standards Update No. 2017-04, Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment (ASU 2017-04) to simplify the subsequent measurement of goodwill. The guidance removes Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. A goodwill impairment will now be the amount by which a reporting unit’s carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The accounting standard became effective for us beginning January 1, 2020, and did not have a material impact on the Company’s consolidated financial position, results of operations or cash flows.

*Income Taxes*

In December 2019, the FASB issued Accounting Standard Update No. 2019-12, Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes (ASU 2019-12), which simplifies the accounting for income taxes. This guidance will be effective for us in the first quarter of 2021 on a prospective basis, and early adoption is permitted. We are currently evaluating the impact of the new guidance on our consolidated financial statements.

**3. Stock- Based Awards and Stock-Based Employee Compensation Expense**

Our stock-based awards include (i) stock options, (ii) restricted stock awards, some of which are subject to time-based vesting (“Restricted Stock”) and some of which are subject to performance-based vesting (“Performance Stock”), and (iii) restricted stock units, some of which are subject to time-based vesting (“RSUs”) and some of which are subject to performance-based vesting (“Performance RSUs”). As of March 31, 2020, the Company had 809,510 stock options outstanding, 2,354,445 non-vested Restricted Stock awards; 723,517 non-vested Performance Stock awards; 238,643 non-vested RSUs; 77,197 non-vested Performance RSUs and 2,381,311 shares of common stock available for grant future award grants.

### Stock Option Activity

The following is a summary of all stock option transactions during the three months ended March 31, 2020:

	<u>Options</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Term (Yrs)</u>
Outstanding at December 31, 2019	756,385	\$ 3.39	4.46
Granted at market price	100,000	8.03	
Cancelled or expired	—	—	
Exercised	(46,875)	2.49	
Outstanding at March 31, 2020	<u>809,510</u>	<u>\$ 4.02</u>	<u>5.03</u>
Options exercisable at March 31, 2020	<u>697,010</u>	<u>\$ 3.45</u>	<u>4.30</u>

At March 31, 2020, 809,510 stock options outstanding and 697,010 stock options exercisable had an exercise price lower than the market price of the Company's common stock on that date. The aggregate intrinsic value of these stock options were \$625 thousand and \$621 thousand, respectively.

### Restricted Stock Activity

The following is a summary of Restricted Stock activity during the three months ended March 31, 2020:

	<u>Restricted Shares</u>	<u>Weighted Average Fair Value</u>
Non-vested restricted stock at December 31, 2019	1,912,082	\$ 6.26
Granted at market price	1,155,981	8.05
Vested	(620,317)	5.89
Cancelled	(93,301)	6.01
Non-vested restricted stock at March 31, 2020	<u>2,354,445</u>	<u>\$ 7.26</u>

### Restricted Stock Unit Activity

The following is a summary of all RSU activity during the three months ended March 31, 2020:

	<u>Restricted Stock Units</u>	<u>Weighted Average Fair Value</u>
Non-vested restricted stock units at December 31, 2019	140,075	\$ 7.59
Granted at market price	135,226	8.33
Vested	(36,658)	5.96
Cancelled	—	—
Non-vested restricted stock units at March 31, 2020	<u>238,643</u>	<u>\$ 8.26</u>

### Performance RSU Activity

The following is a summary of all Performance RSU activity during the three months ended March 31, 2020:

	<u>Performance RSUs</u>	<u>Weighted Average Fair Value</u>
Non-vested performance RSUs at December 31, 2019	55,499	\$ 8.39
Granted at market price	42,030	8.03
Vested	(16,062)	8.06
Forfeited	(4,270)	8.05
Non-vested performance RSUs at March 31, 2020	<u>77,197</u>	<u>\$ 8.28</u>

### Performance Stock Activity

The following is a summary of all Performance Stock activity during the three months ended March 31, 2020:

	Performance Stock	Weighted Average Fair Value
Non-vested performance stock at December 31, 2019	474,568	\$ 6.38
Granted at market price	446,170	8.03
Vested	(155,797)	6.00
Forfeited	(41,424)	6.00
Non-vested performance stock at March 31, 2020	<u>723,517</u>	<u>\$ 7.48</u>

The weighted average grant-date fair value of awards of Restricted Stock, RSUs, Performance RSUs and Performance Stock is based on the quoted market price of the Company's common stock on the date of grant.

### Stock-Based Compensation Expense

For the three month period ended March 31, 2020, the total stock-based employee compensation expense resulting from stock options, Restricted Stock, RSUs, Performance RSUs and Performance Stock was recorded to the following line items of the Company's condensed consolidated statement of comprehensive loss:

(In thousands)	Three Months Ended March 31, 2020
Cost of revenues	\$ 172
Research and development	337
Selling, general and administrative	1,482
Stock-based compensation expense	<u>\$ 1,991</u>

A deferred tax asset totaling \$391 thousand and \$236 thousand, resulting from stock-based compensation expense associated with awards relating to the Company's U.S. operations, was recorded for the three month periods ended March 31, 2020 and 2019, respectively. As of March 31, 2020, there was \$22.5 million of total unrecognized stock-based compensation expense related to non-vested stock-based compensation awards granted under the incentive plans. This expense is expected to be recognized over a weighted average period of 2.43 years.

For additional information regarding the Company's Equity Awards and Stock-based Employee Compensation, see Note 3, *Stock Options and Stock-Based Employee Compensation* of the "Notes to Consolidated Financial Statements" included in our Annual Report on Form 10-K for the year ended December 31, 2019.

### 4. Supplemental Cash Flow Information

Supplemental cash flow information relating to taxes and non-cash activities:

(In thousands)	Three Months Ended March 31,	
	2020	2019
Interest payments	\$ 1,566	-
Income tax payments	44	193
Non-cash investing and financing activities:		
Accrued and deemed dividends on Series A preferred stock	2,229	1,982
Accrued and deemed dividends on Series B preferred stock	-	451

## 5. Receivables, net

(In thousands)	March 31, 2020	December 31, 2019
Gross accounts receivables	\$ 26,167	\$ 21,193
Allowance for credit losses	(265)	—
Allowance for returns and doubtful accounts	—	(265)
Unpaid portion of deferred revenue	(12,865)	(10,847)
Note receivable	458	458
Allowance for note receivable	(458)	(458)
Receivables, net	<u>\$ 13,037</u>	<u>\$ 10,081</u>

Prior to January 1, 2020, accounts receivable were recorded at cost less an allowance for doubtful accounts. We maintained an allowance for uncollectible accounts receivable for estimated losses resulting from the failure or inability of our customers to make required payments. Subsequent to January 1, 2020, accounts receivable are recorded at cost less an allowance for credit losses. We estimate losses on receivables at the reporting date based on expected losses resulting from the inability of our customers to make required payments, including our historical experience of actual losses and the aging of such receivables. These receivables have been pooled by shared risk characteristics. Based on known information we may also establish specific reserves for customers in an adverse financial condition or adjust our expectations of changes in conditions that may impact the collectability of outstanding receivables. As of March 31, 2020, based on available information to date, the Company assessed no material impact related to potential losses caused by COVID-19.

The reduction for the unpaid portion of deferred revenue represents future customer service or maintenance obligations that have been billed to customers, but remain unpaid as of the respective balance sheet dates. Deferred revenue on our consolidated balance sheets represents future customer service or maintenance obligations that have been billed and collected as of the respective balance sheet dates.

The note receivable represents the remaining outstanding balance of an original note related to the sale of a product line in 2005 in the amount of \$540 thousand. This was fully reserved at the time of the sale, as the note's collectability was not assured. The note receivable is fully reserved at March 31, 2020.

## 6. Leases

Effective January 1, 2019, the Company adopted ASC 842, which requires recognition of a right-of-use asset and lease liability for all leases at the commencement date based on the present value of lease payments over the lease term. Additional qualitative and quantitative disclosures regarding the Company's leasing arrangements are also required. The Company adopted ASC 842 prospectively and elected the package of transition practical expedients that does not require reassessment of (1) whether any existing or expired contracts are or contain leases, (2) lease classification and (3) initial direct costs. In addition, the Company has elected other available practical expedients to not separate lease and nonlease components, which consist principally of common area maintenance charges, for all classes of underlying assets and to exclude leases with an initial term of 12 months or less.

The Company determines if a contract is or contains a lease at inception. The Company has operating leases for office spaces and data centers and finance leases for equipment. The Company has entered into lease contracts ranging from 1 to 12 years with the majority of leases having terms one to seven years, many of which include options to extend in various increments. Variable lease costs consist primarily of variable common area maintenance, taxes, insurance, parking and utilities. The Company's leases do not have any residual value guarantees or restrictive covenants.

As the implicit rate is not readily determinable for most of the Company's lease agreements, the Company uses an estimated incremental borrowing rate to determine the initial present value of lease payments. These discount rates for leases are calculated using the Company's weighted average interest rate of the term loan and delayed draw term loan.

The components of lease costs are as follows:

(In thousands)	Three Months ended March 31, 2020
<b>Finance lease costs:</b>	
Amortization of right-of-use assets	\$ 378
Interest on lease liabilities	29
Operating lease costs	941
Short-term lease costs	400
Variable lease costs	217
Total lease costs	<u>\$ 1,965</u>

Supplemental cash flow information related to leases are as follows:

(In thousands)	Three Months ended March 31, 2020
<b>Cash paid for amounts included in the measurement of lease liabilities:</b>	
Operating cash flows from operating leases	\$ 973
Operating cash flows related to finance leases	29
Financing cash flows related to finance leases	406
<b>Right-of-use assets obtained in exchange for lease obligations:</b>	
Operating leases	365
Finance leases	—

Supplemental balance sheet information related to leases are as follows:

(In thousands)	Balance Sheet Classification	March 31, 2020
<b>Operating Leases</b>		
Operating lease right-of-use assets	Operating lease assets	\$ 9,709
Total operating lease assets		<u>\$ 9,709</u>

(In thousands)	Balance Sheet Classification	March 31, 2020
<b>Finance Leases</b>		
Finance lease right-of-use assets		\$ 3,362
Accumulated depreciation - finance leases		(1,695)
Finance lease right-of-use assets, net	Property and equipment, net	<u>\$ 1,667</u>

Weighted average remaining lease term and weighted average discount rate are as follows:

<b>Weighted Average Remaining Lease Term (Years)</b>	
Operating leases	4.12
Finance leases	1.78
<b>Weighted Average Discount Rate</b>	
Operating leases	5.82%
Finance leases	6.15%

Maturities of lease liabilities are as follows:

(In thousands)	Payments Due by Period - Year Ending December 31, 2020				
	Total	Year 1 (1)	Years 2 & 3	Years 4 & 5	Beyond 5 Years
Operating leases	\$ 12,269	\$ 2,590	\$ 5,216	\$ 4,295	\$ 168
Less imputed interest	(2,182)				
<b>Total</b>	<b>\$ 10,087</b>				
Finance leases	\$ 1,730	\$ 988	\$ 736	\$ 6	\$ —
Less imputed interest	(81)				
<b>Total</b>	<b>\$ 1,649</b>				

(1) Year 1 excluding the three months ended March 31, 2020

During the quarter ended March 31, 2020, we entered into operating leases for additional office space and data center, which have not yet commenced and are expected to be added as a lease liability at a value of approximately \$217 thousand. These operating leases will commence in the second quarter of 2020 with lease terms of between 2 to 5 years.

## 7. Long-term Debt

On February 20, 2019, the Company entered into a credit agreement (the “Credit Agreement”) with a syndicate of lenders and SunTrust Bank as administrative agent, which (1) provided for borrowing in the form of a senior secured term loan facility in an aggregate principal amount of \$175 million (the “Term Loan”), (2) provided for a senior secured delayed draw term loan facility in an aggregate principal amount of \$10 million (the “Delayed Draw Term Loan Facility”), and (3) provided for a senior secured revolving credit facility in an aggregate principal amount of \$25 million, up to \$5 million of which is available for letters of credit (the “Revolving Facility” and, together with the Term Loan and the Delayed Draw Term Loan Facility, the “Credit Facilities”). On February 20, 2019, the Term Loan was borrowed in full to pay a portion of the purchase price in connection with the AppRiver acquisition (described below in Note 16 “Acquisitions”) including certain fees, costs and expenses related thereto. On May 2, 2019, the Delayed Draw Term Loan Facility was borrowed in full to pay a portion of the purchase price in connection with the DeliverySlip acquisition (described below in Note 16 “Acquisitions”), including certain fees, costs and expenses related thereto. As of March 31, 2020, the Company had an outstanding debt balance of \$8.0 million attributable to the Revolving Facility. The Credit Facilities are secured by substantially all the assets of Zix and its wholly-owned domestic subsidiaries and guaranteed by substantially all of Zix’s wholly-owned domestic subsidiaries.

Borrowings under the Credit Agreement bear interest, at the Company’s option, at either (1) the adjusted LIBOR rate (as defined in the Credit Agreement) plus a margin ranging from 2.50% to 3.50% or (2) the alternate base rate (as defined in the Credit Agreement) plus a margin ranging from 1.50% to 2.50%. The applicable margin varies depending on the Company’s total net leverage ratio.

The Credit Facilities are scheduled to mature on February 20, 2024, unless extended in accordance with the terms of the Credit Agreement. The Credit Agreement includes procedures for additional financial institutions to become lenders, or for any existing lender to increase its commitments thereunder, subject to the limits and conditions set forth in the Credit Agreement.

Optional prepayments of borrowings under the Credit Facilities are permitted at any time and do not require any prepayment premium (other than reimbursement of the lenders’ breakage and redeployment costs in the case of a prepayment of LIBOR borrowings).

The Credit Agreement contains various financial, operational, and legal covenants. The financial covenant is tested on a quarterly basis, based on the rolling four-quarter period that ends on the last day of each fiscal quarter. The financial covenant requires the Company to maintain a maximum total net leverage ratio of:

- 5.00:1.00 for the fiscal quarters ending December 31, 2019 through June 30, 2020;
- 4.75:1.00 for the fiscal quarters ending September 30, 2020 through March 31, 2021;
- 4.50:1.00 for the fiscal quarters ending June 30, 2021 through December 31, 2021; and
- 4.25:1.00 for the fiscal quarter ending March 31, 2022 and each fiscal quarter thereafter.

The non-financial covenants restrict the Company's ability and the ability of the Company's restricted subsidiaries to, among other things, incur indebtedness, incur liens, merge with or acquire other entities, make investments, dispose of assets, enter into sale and leaseback transactions, make dividends, distributions or stock repurchases, prepay junior indebtedness, enter into transactions with affiliates, enter into restrictive agreements, and amend organizational documents or the terms of junior indebtedness.

The Credit Agreement contains events of default that Zix believes are customary for a secured credit facility. If an event of default relating to bankruptcy or other insolvency events occurs, all obligations under the Credit Agreement will immediately become due and payable. If any other event of default exists under the Credit Agreement, the lenders may accelerate the maturity of the Credit Facilities and exercise other rights and remedies, including foreclosure or other actions against the collateral. If any default exists under the Credit Agreement, or if the Company is unable to make any of the representations and warranties in the Credit Agreement at the applicable time, Zix will be unable to borrow additional funds or have letters of credit issued under the Credit Agreement.

#### **Term Loan**

As of March 31, 2020, the Company had \$173.3 million in principal outstanding under the Term Loan. The Term Loan was fully drawn on February 20, 2019 in the amount of \$175 million, and requires quarterly payments of principal of \$437,500 beginning on June 30, 2019. In addition to other customary mandatory prepayment requirements, the Term Loan requires annual prepayments based on a percentage of Zix's excess cash flow, which percentage will reduce if Zix's total net leverage ratio decreases. Based on the calculation of excess cash flow and total net leverage ratio and for the year ended December 31, 2019, the Company is not required to make prepayment in addition to the quarterly installment.

At March 31, 2020, the Company had an outstanding debt balance of \$168.1 million based on the 5.77% interest rate in effect during the three-month period ended on March 31, 2020. Included in the balance at March 31, 2020 is \$5.2 million of unamortized debt issuance costs.

Future principal payments under the Term Loan as of March 31, 2020 are as follows:

<b>(In thousands)</b>	<b>Amount</b>
<b>Year Ending December 31,</b>	
2020	1,313
2021	1,750
2022	1,750
2023	1,750
2024	166,687
	<u>173,250</u>

#### **Delayed Draw Term Loan Facility**

At March 31, 2020, the Company had \$9.9 million in principal outstanding under the Delayed Draw Term Loan Facility. The Delayed Draw Term Loan Facility was fully drawn on May 2, 2019 in the amount of \$10 million to fund the DeliverySlip acquisition. The Delayed Draw Term Loan Facility requires 1.00% per annum amortization of the original principal amount borrowed, payable in equal quarterly installments of \$25 thousand beginning on September 30, 2019. In addition to other customary mandatory prepayment requirements, the Delayed Draw Term Loan Facility requires annual prepayments based on a percentage of Zix's excess cash flow, which percentage reduces if Zix's total net leverage ratio decreases. Based on the calculation of excess cash flow and total net leverage ratio and for the year ended December 31, 2019, the Company is not required to make prepayment in addition to the quarterly installment.

At March 31, 2020, the Company had an outstanding debt balance of \$9.9 million attributable to the Delayed Draw Term Loan Facility based on the 5.12% interest rate in effect during the three month period ended March 31, 2020. Included in the balance at March 31, 2020 is \$43 thousand of unamortized debt issuance costs.

Future principal payments under the Delayed Draw Term Loan Facility as of March 31, 2020 are as follows:

(In thousands) Year Ending December 31,	Amount
2020	75
2021	100
2022	100
2023	100
2024	9,550
	9,925

### ***Revolving Facility***

The Company also has a Revolving Facility with the lenders, pursuant to which the lenders agreed to make a Revolving Facility available to the Company in an aggregate amount of up to \$25 million. Proceeds from the Revolving Facility may be used for working capital and general business purposes, including the financing of permitted acquisitions, investments and restricted payments, subject, in both cases, to the conditions contained in the Credit Agreement. Zix is charged a commitment fee ranging from 0.25% to 0.50% per year on the daily amount of the unused portions of the commitments under the Revolving Facility.

As of March 31, 2020, the Company had an outstanding debt balance of \$8.0 million attributable to the Revolving Facility. The undrawn balance of \$17 million is available to fund working capital and for other general corporate purposes, including the financing of permitted acquisitions, investments and restricted payments, subject to the conditions contained in the Credit Agreement. As of March 31, 2020, the Company has incurred \$22 thousand of commitment fees and \$45 thousand of interest expense for the period ended March 31, 2020.

As of March 31, 2020, the estimated fair value of the Credit Facilities approximated their carrying value and the Company was in compliance with all covenants in the Credit Agreement.

### **8. Preferred Stock**

On February 20, 2019, (the “Original Issuance Date” or “Closing Date”), Zix consummated a private placement pursuant to an investment agreement with an investment fund managed by True Wind Capital and issued an aggregate of \$100 million of shares of convertible Preferred Stock (as defined below) at a price of \$1,000 per share (the “Stated Value”). 64,914 shares of Series A Convertible Preferred Stock (the “Series A Preferred Stock”) were issued for proceeds of \$62.7 million, net of issuance costs of \$2.3 million, and 35,086 shares of Series B Convertible Preferred Stock (the “Series B Preferred Stock” and, together with the Series A Preferred Stock, the “Preferred Stock”) were issued for proceeds of \$33.9 million, net of issuance costs of \$1.2 million. The Preferred Stock is classified outside of stockholders’ equity in temporary equity because the shares contain certain redemption features which require redemption upon a change in control. The Series A Preferred Stock can be immediately converted to common stock.

On June 5, 2019, Shareholders approved the conversion of the outstanding shares of Series B Preferred Stock into shares of Series A Preferred Stock. Each share of Series B Preferred Stock was converted into the number of shares of Series A Preferred Stock equal to the liquidation preference of such share of Series B Preferred Stock divided by the accreted value of a share of Series A Preferred Stock on the date of conversion plus cash in lieu of fractional shares. On June 6, 2019, all the outstanding shares of Series B Preferred Stock were converted into 35,292 shares of Series A Preferred Stock. As of March 31, 2020, no shares of Series B Preferred Stock are outstanding.

The conversion option of the Series A Preferred Stock was determined to have a beneficial conversion feature valued at \$2.5 million, excluding the additional beneficial conversion feature accrued for the deemed dividend, and was recorded to additional paid-in capital and as a discount to the Series A Preferred Stock. This resulting discount was immediately amortized as the Series A Preferred Stock has no set redemption date but is currently convertible.

## ***Dividends***

The Stated Value of the Series A Preferred Stock accretes at a fixed rate of 8% per annum, compounded quarterly ("Series A Preferred Dividend"). Apart from the Series A Preferred Dividend, the holders of Series A Preferred Stock are also entitled to receive any dividends paid on our common stock on an "as converted" basis. No dividend may be paid on our common stock until such dividend is paid on the Series A Preferred Stock. All calculations of the Accreted Value (as defined below) of Series A Preferred Stock will be computed on the basis of a 360-day year of twelve 30-day months. As of March 31, 2020, the accretion of the Stated Value of Series A Preferred Stock is valued at \$8.3 million.

## ***Voting Rights***

Holders of Series A Preferred Stock are entitled to vote, together with the holders of common stock on all matters submitted to a vote of the holders of our common stock. Each holder of Series A Preferred Stock shall be entitled to the number of votes equal to the largest number of whole shares of common stock into which all shares of Series A Preferred Stock held by such holder could be converted. The vote or consent of the holders of at least a majority of the shares of Series A Preferred Stock outstanding will be necessary for effecting or validating any of the following actions: (i) any amendment, alteration or repeal of Zix's Articles of Incorporation or Series A Certification of Designations that would adversely affect the rights, preferences, privileges or power of the Series A Preferred Stock; (ii) any amendment or alteration to Zix's Articles of Incorporation or any other action to authorize or create, or increase the number of authorized or issued shares of capital stock of the Company convertible into shares of, or ranking senior to, or on a parity basis with, the Series A Preferred Stock as to dividend rights or liquidation rights; (iii) the issuance of shares of Series A Preferred Stock after the Original Issuance Date other than in connection with the conversion of Series B Preferred Stock that was issued on the Original Issuance Date; (iv) any action that would cause the Company to cease to be treated as a domestic corporation for U.S. federal income tax purposes; and (v) the incurrence of any indebtedness of the Company that would cause Zix to exceed a specified leverage ratio.

## ***Liquidation Preference***

The Series A Preferred Stock has a liquidation preference equal to the greater of (i) the Stated Value per share as it has accreted as of such date (the "Accreted Value") and (ii) the amount such holder would have received if the Series A Preferred Stock had converted into common stock immediately prior to such liquidation.

## ***Conversion***

At any time, each Series A Preferred Stock holder may elect to convert each share of such holders' then-outstanding Series A Preferred Stock into (i) the number of shares of common stock equal to the product of (a) the Accreted Value with respect to such share on the conversion date multiplied by (b) the conversion rate at 166.11 as of the applicable conversion date divided by (c) 1,000 plus (ii) cash in lieu of fractional shares.

## ***Optional Redemption by Zix***

At any time after the fourth anniversary of the Closing Date, Zix may redeem the Series A Preferred Stock for an amount per share of Series A Preferred Stock equal to the Accreted Value per share of the Series A Preferred Stock to be redeemed as of the applicable redemption date multiplied by 1.50.

## **9. Revenue from Contracts with Customers**

### ***Accounting policies***

Our Company provides message security solutions as subscription services in which we recognize revenue as our services are rendered. Our customer contracts historically have ranged from one to three year contracts billed annually. We are increasingly moving to a monthly subscription model. This shift has been largely driven by our recent acquisition activity, including AppRiver in February 2019. We exclude from the measurement of the transaction price all taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue-producing transaction and collected by our Company from a customer (e.g., sales, use, value added, and some excise taxes).

### Disaggregation of Revenue

In the three months ended March 31, 2020, we recorded revenue for our services in the following core industry verticals: 47% healthcare, 28% financial services, 7% government sector, and 18% as other.

We operate as a single operating segment. Revenue generated from our email encryption and security solutions represented 100% of our revenues in the three months ended March 31, 2020 and 2019, respectively.

### Contract balances

Our contract assets include our accounts receivables, discussed above in Footnote 5 “Receivables, net”, and the deferred cost associated with commissions earned by our sales team on securing new, add-on, and renewal contract orders. During the three months ended March 31, 2020, we increased our noncurrent deferred contract asset by \$1.2 million resulting from commissions earned by our sales team during the quarter. We also amortized \$869 thousand of deferred cost as a selling and marketing expense in the same period. Our deferred cost asset is assessed for impairment on a periodic basis. There were no impairment losses recognized on deferred contract cost assets for the three months ended March 31, 2020.

Our contract liabilities consist of deferred revenue representing future customer services which have been billed and collected. The \$1.1 million increase to our net deferred revenue in the three months ended March 31, 2020, is related to the timing of orders and payments.

### Performance obligations

As of March 31, 2020, the aggregate amount of the transaction prices allocated to remaining service performance obligations, which represents the transaction price of firm orders less inception to date revenue, was \$88.5 million. We expect to recognize approximately \$54.5 million of revenue related to this backlog during the remainder of 2020, \$23.0 million in 2021, and \$11.0 million in periods thereafter.

Approximately \$26.7 million of our \$52.4 million revenue recognized in the three months ended March 31, 2020, was included in our performance obligation balance at the beginning of the period.

## 10. Earnings (Loss) Per Share and Potential Dilution

Basic earnings (loss) per share are computed using the weighted average number of common shares outstanding for the applicable period under the Treasury Stock method. The dilutive effect of potential common shares outstanding is included in diluted earnings (loss) per share. The computations for basic and diluted earnings (loss) per share for the three months ended March 31, 2020 and 2019, respectively, are as follows:

	Three Months ended March 31,	
	2020	2019
Basic weighted average common shares	53,496,042	52,713,576
Effect of dilutive securities:		
Employee and director stock options	—	—
Restricted Stock	—	—
RSUs	—	—
Performance RSUs	—	—
Performance Stock	—	—
Series A Preferred Shares	—	—
Series B Preferred Shares	—	—
Dilutive weighted average common shares	53,496,042	52,713,576

During each of the three months ended March 31, 2020 and 2019, potential common shares of all securities were excluded from the calculation of diluted loss per share because the awards were anti-dilutive.

## 11. Commitments and Contingencies

We have not entered into any material, non-cancelable purchase commitments at March 31, 2020.

### Claims and Proceedings

We are from time to time involved in legal claims, litigation, and other legal proceedings. Although we may incur significant expenses in those matters, we expect no material adverse effect on our operations or financial results from current or concluded legal proceedings.

## 12. Fair Value Measurements

FASB guidance regarding fair value measurement establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets for identical assets or liabilities; Level 2, defined as inputs other than quoted prices for similar assets and liabilities in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs for which little or no market data exists, therefore requiring an entity to develop its own assumptions.

For certain of the Company's financial instruments, including cash and cash equivalents, trade receivables, and accounts payable, the fair values approximate the carrying values due to the short-term maturities of these instruments. The carrying values of other current assets and accrued expenses are also not recorded at fair value, but approximate fair values primarily due to their short-term nature.

## 13. Goodwill

The following is a summary of the changes in the carrying amount of goodwill for the three month periods ended March 31, 2020 and 2019:

(In thousands)	Three Months ended March 31,	
	2020	2019
Opening balance	\$ 171,209	\$ 13,783
Additions	—	147,220
Acquisition adjustments	—	—
Effect of currency translation adjustment	(832)	—
Goodwill	<u>\$ 170,377</u>	<u>\$ 161,003</u>

Our 2019 acquisition of AppRiver resulted in the increase to our goodwill in the three months ended March 31, 2019. See below Note 16 "Acquisitions" for additional information regarding our acquisitions.

We evaluate goodwill for impairment annually in the fourth quarter, or when there is a reason to believe that the value has been diminished or impaired. There were no impairments to goodwill during the periods presented above.

## 14. Other Comprehensive Loss

The assets and liabilities of international subsidiaries are translated from the respective local currency to the U.S. dollar using exchange rates at the balance sheet date. Related translation adjustments are recorded as a component of the accumulated other comprehensive income (loss). Our Consolidated Statement of Comprehensive Loss of international subsidiaries are translated from the local currency to the U.S. dollar using average exchange rates for the period covered by the income statements.

We are exposed to fluctuations in the foreign currency exchange rates as a result of our net investments and operations in Canada, United Kingdom, Switzerland and Spain. For three months ended March 31, 2020, movements in currency exchange rates and the related impact on the translation of the balance sheets of our foreign subsidiaries was the primary cause of our foreign currency translation loss of \$905 thousand, net of \$254 thousand in income tax benefit.

## 15. Income Taxes

The operating losses incurred by the Company's U.S. operations in past years and the resulting net operating losses for U.S. Federal tax purposes are subject to a \$22.9 million reserve. Any reduction to this \$22.9 million valuation allowance is based on an assessment of future utilization following accounting guidance, which relies largely on historical earnings. Using this methodology, and updating the future taxable earnings estimates based on first quarter 2020 actual earnings, the Company believes the deferred tax asset allowance as of December 31, 2019, will remain unchanged at December 31, 2020. For this reason, the Company has recognized its first quarter 2020 federal deferred tax provision in full. If in prospective periods we conclude our future U.S. federal taxable estimate established at the end of the year will exceed the prior year estimate, the Company will offset its federal deferred tax provision by reducing its valuation allowance by an equal amount, thereby eliminating from its deferred tax provision federal taxes from the Company's financial statements. The Company will continue to reevaluate the need for its valuation allowance each quarter, following the same assessment methodology described above. Adjusting our valuation allowance could have a significant impact on operating results for each period that it becomes more likely than not that an additional portion of our deferred tax assets will or will not be realized.

## 16. Acquisitions

### Acquisition of DeliverySlip

On May 7, 2019, the Company acquired certain assets of Cirius Messaging Inc. ("Seller") and its wholly owned subsidiary DeliverySlip Inc. ("DeliverySlip"), related to the DeliverySlip product for a total purchase price of \$13.8 million, including cash consideration of \$11.4 million and a contingent consideration with an estimated fair value of \$2.3 million at the acquisition date. The contingent consideration was paid in full upon the completion of certain agreed upon requirements and a related \$0.2 million loss on the contingent consideration was recognized in the year ended December 31, 2019. Included in the cash consideration, a holdback amount of \$1.5 million was transferred to an escrow agent for the satisfaction of the Seller's indemnity and other obligations under the purchase agreement. The acquisition was partially financed with proceeds of \$10 million from the Delayed Draw Term Loan Facility.

The purchase of DeliverySlip expanded the Company's product offering including email encryption, e-signatures and secure file solutions.

The Company incurred \$1.2 million in acquisition-related costs with respect to the DeliverySlip acquisition, which were recorded within operating expenses during the twelve months end December 31, 2019. Prior to the acquisition, approximately 90% of DeliverySlip's revenue was generated from AppRiver Canada Inc, which became a subsidiary of the Company upon closing of the AppRiver acquisition (as described below). Revenue from additional acquired customers of DeliverySlip for the three months ended March 31, 2020 were immaterial.

We accounted for the acquisition as the purchase of a business and recorded the excess purchase price as goodwill. The goodwill from this transaction is not yet finalized. The majority of the goodwill balance is expected to be deductible for tax purposes. The intangible asset we acquired from DeliverySlip is technology which we are amortizing over 6 years. The results of operations and the provisional fair values of the acquired assets and liabilities have been included in the accompanying condensed consolidated financial statements since the DeliverySlip acquisition closed on May 7, 2019. Certain estimated values are not yet finalized and subject to revision as additional information becomes available and more detailed analyses are completed.

The following table summarizes the current estimated fair value of acquired assets and liabilities:

(In thousands)	Estimated Fair Value
<b>Assets:</b>	
Technology	\$ 4,200
Goodwill	9,603
Total assets	13,803
<b>Liabilities:</b>	
Deferred revenue	\$ 52
Total liabilities	52
Net assets recorded	\$ 13,751

## Acquisition of AppRiver Companies

On February 20, 2019, Zix acquired 100% of the equity interest of AR Topco, LLC and its subsidiaries, including AppRiver LLC (“AppRiver” and collectively, the “AppRiver Companies”), for a total purchase price of \$276.4 million, including cash consideration of \$271.8 million, net of cash acquired, and subject to a customary working capital adjustment. This acquisition complements our strategy to accelerate our offerings into the cloud at the point of initial cloud application purchase and expand our customer base.

We financed the acquisition with proceeds from (1) cash on hand, (2) the proceeds from the Term Loan, and (3) a private placement with an investment fund managed by True Wind Capital consisting of (i) 64,914 newly issued shares of Series A Convertible Preferred Stock, \$1.00 par value per share, and (ii) 35,086 newly issued shares of Series B Convertible Preferred Stock, \$1.00 par value per share in exchange for cash consideration in an aggregate amount of \$100 million (which was reduced by \$3 million in True Wind Capital’s costs that were reimbursed by the Company).

AppRiver is a channel-first provider of cloud-based cyber security and productivity services, offering web protection, email encryption, secure archiving, and email continuity solutions. AppRiver also provides Microsoft Office 365 and Secure Hosted Exchange services, which serve as an effective lead generation tool for AppRiver’s solutions. The acquisition of AppRiver can accelerate our offerings into the cloud at the point of initial cloud application purchase. Because AppRiver currently services over 60,000 worldwide customers using a network of 4,500 Managed Service Providers, this acquisition can help us expand our customer base.

The Company incurred \$10.7 million in acquisition-related costs which included \$1.1 million, \$9.6 million and \$34 thousand recorded within the operating expenses during the twelve months ended December 31, 2018 and December 31, 2019 as well as three months ended March 31, 2020, respectively. Revenue from AppRiver was \$32.9 million for the three months ended March 31, 2020, and due to the continued integration of the combined businesses, it was impracticable to determine earnings attributable to AppRiver.

We accounted for the acquisition as the purchase of a business and recorded the excess purchase price as goodwill. The majority of the goodwill balance is expected to be deductible for tax purposes. The intangible assets we acquired from AppRiver consist of customer relationships, vendor relationships, trademarks/names, and internally developed software, which we are amortizing over 8 years, 3 years, 10 years, and 5-6 years, respectively. The results of operations and the provisional fair values of the acquired assets and liabilities have been included in the accompanying condensed consolidated financial statements since the AppRiver acquisition closed on February 20, 2019.

The following table summarizes the estimated fair value of acquired assets and liabilities:

(In thousands)	Estimated Fair Value
<b>Assets:</b>	
Current assets	\$ 12,200
Property and equipment	3,235
ROU assets	8,778
Customer relationships	91,000
Vendor relationships	1,000
Trademark/Names	4,400
Internally developed software	41,100
Deferred tax assets	3,453
Goodwill	147,518
Total assets	<u>312,684</u>
<b>Liabilities:</b>	
Current liabilities	\$ 13,378
Deferred revenue	12,424
Operating lease liabilities	5,738
Finance lease liabilities	3,440
Total liabilities	<u>34,980</u>
Net assets recorded	<u>\$ 277,704</u>

**Pro Forma Financial Information (Unaudited)**

The following unaudited pro forma financial information presents the combined results of operations for the three month periods ending March 31, 2020 and 2019, respectively, as though the DeliverySlip and AppRiver acquisitions that occurred during the reporting period had occurred as of the beginning of the period presented, with adjustments, such as amortization expense of intangible assets and acquisition-related transaction costs, to give effect to pro forma events that are directly attributable to the acquisitions. These unaudited pro forma results are presented for information purposes only and are not necessarily indicative of what the actual results of operations of the combined company would have been if the respective acquisitions had occurred at the beginning of the period presented, nor are they indicative of future results of operations:

(In thousands, except per share data)	Three Months Ended March 31,	
	2020	2019
Revenues	\$ 52,519	\$ 46,891
Net income	4,013	4,872
Basic income per share attributed to common shareholders	\$ 0.03	\$ 0.02
Diluted income per share attributed to common shareholders	\$ 0.03	\$ 0.02

**NOTE ON FORWARD-LOOKING STATEMENTS AND RISK FACTORS**

Statements in this report which are not purely historical facts or which necessarily depend upon future events, including statements about trends, uncertainties, hopes, beliefs, anticipations, expectations, plans, intentions or strategies for the future, may be forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934. Forward-looking statements involve risks and uncertainties that could cause actual events or results to differ materially from the events or results described in the forward-looking statements, including risks and uncertainties related to how privacy and data security law mandates may affect demand for Zix's products, business disruptions, uncertainty and market instability stemming from the COVID-19 pandemic as well as governmental actions related thereto, and those risks additionally described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2019. Any of these risk factors could have a material adverse effect on our business, financial condition or financial results and reduce the value of an investment in our securities. We may not succeed in addressing these and other risks associated with an investment in our securities, with our business and with our achieving any forward-looking statements. Readers are cautioned not to place undue reliance on forward-looking statements. All forward-looking statements are based upon information available to us on the date the statements are made. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

**Overview**

Zix® is a leading provider of cloud email security, productivity and compliance solutions. Trusted by the nation's most influential institutions in healthcare, finance and government, Zix delivers a superior experience and easy-to-use solutions for email encryption and data loss prevention ("DLP"), advanced threat protection and archiving. As a leading provider of cloud-based cybersecurity, compliance, and productivity solutions for businesses of all sizes, we are focused on the protection of business communication, enabling our customers to better secure data and meet compliance needs. We serve organizations in many industries, with particular emphasis on the healthcare (including multiple major hospitals and several Blue Cross Blue Shield plans), financial services (including several U.S. Banks), and insurance and government (including divisions of the U.S. Treasury and the U.S. Securities and Exchange Commission (the "SEC")) sectors.

Our email encryption and DLP capabilities enable the secure exchange of email that includes sensitive information. Through a comprehensive secure messaging service, called Email Encryption (formerly ZixEncrypt), we allow an enterprise to use policy-driven rules to determine which email messages should be sent securely or quarantined for review to comply with regulations or company-defined policies.

The main differentiation for Email Encryption in the marketplace is our exceptional ease of use. The best example of this is our ability to provide transparent delivery of encrypted email. Most email encryption solutions are focused on the sender. They typically introduce an added burden on recipients, often requiring additional user authentication with the creation of a new user identity and password. We designed our solution to alleviate the recipient's burden by enabling the delivery of encrypted email automatically and transparently. Zix enables transparent delivery through (1) The Directory (formerly ZixDirectory®), the world's largest email encryption community which is designed to share identities of our tens of millions of members, (2) Zix's patented Best Method of Delivery®, which is designed to deliver email in the most secure, most convenient method possible for the recipient, and (3) Email Encryption, which automatically encrypts and decrypts messages with sensitive content. The result is secure, transparent encrypted email, such that secure email can be exchanged without any impact to administrators or extra steps for both senders and recipients. Our Email Encryption also addresses a business's greatest source of data loss – corporate email– with an easy, straightforward DLP approach. By focusing strictly on the risks of email, Email Encryption simplifies DLP in comparison to other DLP solutions by decreasing complexity and cost, reducing deployment time from months to hours and minimizing impact on customer resources and workflow. In addition, Zix offers a convenient experience for both employees interacting with our solution and administrators managing the system.

Our Email Encryption solution enables DLP capabilities for email by combining proven policy and content scanning capabilities with quarantine functionality. The quarantine system and its intuitive interface allow administrators to (1) easily define policies and create custom lexicons for quarantining email messages, (2) conveniently manage quarantined messages using flexible searching and filtering options, (3) release or delete individual or multiple quarantined messages with one click, (4) review reports that monitor quarantine activities and trends and (5) automate custom notifications informing employees of quarantined messages.

Email Encryption from Zix also provides greater visibility into an organization's data risks in email by capturing data in outbound emails and highlighting violations that trigger policy filters to encrypt or quarantine. Through our interactive, real-time interface, companies can monitor their greatest vulnerabilities, generate reports for business executives and train employees about the sensitivity of their company's data.

The solution is available as a hosted solution, as a multi-tenant solution, or as a physical or virtual on-premises appliance.

In March 2017, Zix acquired Greenview Data, Inc. ("Greenview"), an email security company. Zix's acquisition of Greenview addresses increasing buyer demand for email security bundles by adding advanced threat protection, antivirus, anti-spam and archiving capabilities to its industry-leading email encryption. Greenview was a good fit for Zix's business based on its employees' expertise in email security and its emphasis on customer success, which align with Zix's reputation for delivering industry-leading solutions and a superior experience.

Through the acquisition of Greenview, Zix launched two new solutions in April 2017 – ZixProtect<sup>SM</sup> and ZixArchive<sup>SM</sup>. ZixProtect is now called Advanced Email Threat Protection while ZixArchive is called Information Archive. Advanced Email Threat Protection defends organizations from zero-day malware, ransomware, phishing, CEO fraud, W-2 phishing attacks, spam and viruses in email with multi-layer filtering techniques. Accuracy in protecting organizations from email threats is increased further with automated traffic analysis, machine learning and real-time threat analysis. The solution is available as a cloud-based service in a variety of bundles. Information Archive (formerly ZixArchive) is a low-cost, cloud-based email retention solution that easily enables user retrieval, compliance and eDiscovery. Available as a standalone or add-on solution for other products, Zix's Information Archive includes policy-based retention, automatic indexing and flexible search capabilities for audit and legal requirements. With on-demand access through the cloud, organizations can conveniently share messages with employees, auditors and outside consultants or legal counsel, as well as revoke access when needed.

In April 2018, Zix acquired Erado, a unified archiving company. Erado strengthened Zix's comprehensive archiving solutions with unified archiving, supervision, security, and messaging solutions for customers that demand bundled services. Erado's long standing focus on helping its customers comply with FINRA and SEC regulations helped further strengthen Zix's offerings for customers with compliance requirements. This acquisition also expanded Zix's cloud-based email archiving capabilities into more than 50 content channels, including social media, instant message, mobile, web, audio and video.

On February 20, 2019, Zix acquired AppRiver, a leading provider of cloud-based cybersecurity solutions for Small and Medium Businesses ("SMB"). The combined company creates one of the leading cloud based security solutions providers, particularly for the small and mid-size enterprise market. This acquisition further strengthened that alignment by bolstering our security offerings, expanding our go-to-market channels, and providing a stronger cloud platform to drive even more value for our customers and partners. In addition, we now can directly offer Microsoft's substantial catalog of productivity and Microsoft Office 365 cloud email solutions.

On May 7, 2019, Zix acquired DeliverySlip, expanding our portfolio with additional email encryption, e-signatures, and secure file sharing solutions.

Our business operations and service offerings are supported by the ZixData Center<sup>TM</sup>, which is PCI DSS 3.2 certified for applicable services, SOC2 accredited and SOC 3 certified. The operations of the ZixData Center are independently audited annually to maintain AICPA SOC3 certification in the areas of security, confidentiality, integrity and availability. Auditors also produce a SOC2 report on the effectiveness of operational controls used over the audit period.

Our company was incorporated as a corporation in Texas in 1988. Originally named Amtech Corporation, we changed our name to ZixIt<sup>®</sup> Corporation in 1999 when we entered the encrypted email market. In 2002, we became Zix Corporation, and in 2017, the Company rebranded to Zix.

## Impacts of COVID-19

In March 2020, the World Health Organization declared the outbreak of a novel strain of the coronavirus ("COVID-19") to be a pandemic. The pandemic has resulted in significant, unpredictable, and rapidly changing impacts on the United States and global economies. The COVID-19 crisis and government responses have included limiting the operations of non-essential businesses and may result in long-term harm or permanent closures impacting our customers and our vendors. While COVID-19 had a minimal impact to our first quarter 2020 financial results, Zix has taken steps to insure the resilience of our company, while protecting the email security of our customers and the health of our employees, including the following actions:

- Offering healthy email checks and evaluating other efficiency solutions for our customers;
- Working with partners and customers to provide more flexible billing schedules;

- Moving over 95% of our employees to remote work arrangements while maintaining the integrity of our data center operations and providing continued phenomenal support for our customers;
- Maintaining effective governance and internal controls in a remote work environment;
- Slowing our hiring plans, and reducing planned travel and conference expenses;
- Continued review and adjustment of other operating expenses for potential savings, including reduction of excess capacities in our network data centers;

We have continued to provide our cloud email security, productivity and compliance solutions services to our customers and vendors during this ongoing pandemic. The full extent of the impact of the COVID-19 pandemic on the Company's operational and financial performance is currently uncertain and will depend on many factors outside the Company's control, including, without limitation, the timing, extent, trajectory and duration of the pandemic, the development and availability of effective treatments and vaccines, the imposition of protective public safety measures, and the impact of the pandemic on the global economy and demand for consumer products. See the additional risk factor included in Part II – Item 1A of this quarterly report.

### **Critical Accounting Policies and Estimates**

The preparation of financial statements and related disclosures in accordance with accounting principles generally accepted in the United States requires the Company's management to make estimates and assumptions that affect the amounts reported in the Company's condensed consolidated financial statements and accompanying notes. These estimates and assumptions take into account historical and forward looking factors that the Company believes are reasonable, including but not limited to the potential impacts arising from the recent COVID-19 and public and private sector policies and initiatives aimed at reducing its transmission. As the extent and duration of the impacts of COVID-19 remain unclear, the Company's estimates and assumptions may evolve as conditions change. Actual results could differ from these estimates and assumptions. Critical accounting policies and estimates are defined as those that are both most important to the portrayal of the Company's financial condition and results and require management's most subjective judgments.

We describe our significant accounting policies in Note 2, *Summary of Significant Accounting Policies*, of the "Notes to Consolidated Financial Statements" included in our Annual Report on Form 10-K for the year ended December 31, 2019. We discuss our *Critical Accounting Policies and Estimates* in "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the year ended December 31, 2019.

### **Results of Operations**

#### ***First Quarter 2020 Summary of Operations***

##### ***Financial***

- Revenue for the quarter ended March 31, 2020, was \$52.4 million, compared with \$29.3 million for the same period in 2019, representing a 79% increase.
- Gross margin for the quarter ended March 31, 2020, was \$26.4 million (or 50% of revenues), compared with \$18.2 million (or 62% of revenues) for the comparable period in 2019.
- Net loss for the quarter ended March 31, 2020, was \$0.9 million, compared with net loss of \$6.3 million in the comparable period in 2019.
- Net loss attributable to common shareholders for the quarter ended March 31, 2020, was \$3.1 million, compared with net loss attributable to common shareholders of \$8.7 million in the comparable period in 2019. The Company's net loss attributable to common shareholders includes a deemed and accrued dividend to preferred shareholders of \$2.2 million and \$2.4 million, for the three month periods ended March 31 2020 and 2019, respectively
- Net loss per diluted share was \$0.06 for the quarter ended March 31, 2020, compared with net loss per diluted share of \$0.17 in the comparable period in 2019.
- Ending cash and cash equivalents were \$16.3 million on March 31, 2020, compared with \$16.7 million on March 31, 2019, and \$13.3 million on December 31, 2019.

## Operations

- Total billings for the quarter ended March 31, 2020, were \$55.8 million, compared with \$28.5 million for the same period in 2019, representing a 96% increase. AppRiver contributed billings of \$33.3 million and \$10.0 million for the first quarter 2020 and 2019, respectively.
- The annual recurring revenue value of our customer subscriptions as of March 31, 2020, was \$214.3 million, compared with \$188.0 million for the same period in 2019, representing an increase of \$26.3 million.
- Net cash provided by operations in the three months ended March 31, 2020, was \$4.4 million, compared with \$417 thousand used by operations for the same period in 2019, representing a \$4.8 million increase
- As of March 31, 2020, backlog was \$88.5 million, compared with \$87.1 million as of March 31, 2019, representing a 2% increase.

## Revenues

Our Company provides subscription-based services. The following table sets forth the quarter-over-quarter comparison of the Company's revenues:

(in thousands)	Three Months Ended March 31,		3-month Variance 2020 vs. 2019	
	2020	2019	\$	%
Revenues	\$ 52,434	\$ 29,300	\$ 23,134	79%

AppRiver's contribution to our first quarter 2019 revenue was impacted by the February 20, 2019, acquisition date. Combining a full first quarter of operating activity in 2020 with steady trial conversions through the remainder of 2019, resulted in a \$22 million increase in year over year revenue attributable to AppRiver sales. We additionally grew our revenue with continued success in our subscription-based business model with both steady additions to the subscriber base and a high rate of existing customer renewals and the realization of previously contracted revenue in our backlog. In the first three months of 2020, we categorized our revenue in the following core industry verticals: 20% healthcare, 18% financial services, 3% government sector, and 59% as other. In the first three months of 2019, excluding our AppRiver and Erado sales, we categorized our revenue in the following core industry verticals: 47% healthcare, 28% financial services, 7% government sector and 18% as other.

## Annual Recurring Revenue

We measure the health of our subscriber base by the growth of our Annual Recurring Revenue ("ARR"), which is defined as the aggregate annualized contract value attributable to recurring revenue contracts as of the end of the applicable reporting period. We calculate ARR by determining the annual or monthly revenue of subscription agreements that are active as of the end of the applicable period and multiplying by 1 or 12. ARR aids us in determining to what extent individual customer relationships, considered in the aggregate, are growing or declining in financial magnitude. ARR is summarized in the table below:

(in thousands)	As of March 31,		Variance 2020 vs. 2019	
	2020	2019	\$	%
Annual Recurring Revenue	\$ 214,315	\$ 187,989	\$ 26,326	14%

## Backlog

Our end-user order backlog is comprised of contractually binding agreements that we expect to amortize into revenue as the services are performed. The timing of revenue is affected by both the length of time required to deploy a service and the length of the service contract.

As of March 31, 2020, total backlog was \$88.5 million, and we expect approximately 71% of the total backlog, or approximately \$62.9 million, to be recognized as revenue during the next twelve months. As of March 31, 2020, the backlog was comprised of the following elements: \$44.4 million of deferred revenue that has been billed and paid, \$12.9 million billed but unpaid, and approximately \$31.2 million of unbilled contracts. The backlog at March 31, 2020, was 2% higher than the \$87.1 million backlog at the end of the first quarter 2019, and 1% lower than the ending backlog of \$89.3 million at December 31, 2019. Our decrease in backlog is the result of timing of our customer contracts and our continued shift toward a monthly subscription model.

### Cost of Revenues

The following table sets forth the quarter-over-quarter comparison of the cost of revenues:

(in thousands)	Three Months Ended March 31,		3-month Variance 2020 vs. 2019	
	2020	2019	\$	%
Cost of revenues	\$ 26,079	\$ 11,139	\$ 14,940	134%

Cost of revenues is comprised of costs related to operating and maintaining the ZixData Center, a field deployment team, customer service and support, Microsoft fees associated with the resale of Microsoft Office365 and hosted exchange products, and the amortization of Company-owned, customer-based computer appliances. The increases in 2020 compared to 2019 reflected in the table above resulted primarily from our acquisition of AppRiver in February 2019. As a reseller of Microsoft Office365 and hosted exchange products, which comprise over 75% of AppRiver revenue earned in the first quarter of 2020, we expect our costs of revenue to remain at higher levels than we have historically incurred. We additionally incurred increases in our depreciation and amortization expense.

### Research and Development Expenses

The following table sets forth the quarter-over-quarter comparison of our research and development expenses:

(in thousands)	Three Months Ended March 31,		3-month Variance 2020 vs. 2019	
	2020	2019	\$	%
Research and development expenses	\$ 5,386	\$ 4,147	\$ 1,239	30%

Research and development expenses consist primarily of salary, benefits, and stock-based compensation for our development staff, independent development contractor expenses, and other direct and indirect costs associated with enhancing our existing products and services and developing new products and services. The increase in 2020 compared to 2019 reflected in the table above resulted primarily from the recognition of a full quarter of AppRiver employee expenses in 2020 as compared to expenses recorded in the first quarter 2019 following the February 20, 2019, acquisition date. Amortization of previously capitalized internal use software also increased due to project completions.

### Selling and Marketing Expenses

The following table sets forth the quarter-over-quarter comparison of our selling and marketing expenses:

(in thousands)	Three Months Ended March 31,		3-month Variance 2020 vs. 2019	
	2020	2019	\$	%
Selling and marketing expenses	\$ 14,341	\$ 9,934	\$ 4,407	44%

Selling and marketing expenses consist primarily of salary, commissions, travel, stock-based compensation and employee benefits for selling and marketing personnel as well as costs associated with promotional activities and advertising. The increase in the three months ended March 31, 2020, compared to the same period in 2019, was due primarily to the recognition of a full quarter of acquired intangible assets and AppRiver employee expenses in 2020 as compared to expenses recorded in the first quarter 2019 following the February 20, 2019, acquisition date.

### General and Administrative Expenses

The following table sets forth the quarter-over-quarter comparison of our general and administrative expenses:

(in thousands)	Three Months Ended March 31,		3-month Variance 2020 vs. 2019	
	2020	2019	\$	%
General and administrative expenses	\$ 5,688	\$ 10,330	\$ (4,642)	(45)%

General and administrative expenses consist primarily of salary and bonuses, travel, stock-based compensation and benefits for administrative and executive personnel as well as fees for professional services and other general corporate activities. The decrease in the three months ended March 31, 2020, compared with the same period in 2019 resulted primarily from costs associated with our AppRiver acquisition in February 2019.

### ***Other Income (Expense)***

Our other income (expense) consists primarily of interest expense associated with our debt. On February 20, 2019, we entered into a credit agreement with a syndicate of lenders and SunTrust Bank. During the three months ended March 31, 2020 and 2019, we recorded interest expense of \$2.6 million and \$1.3 million, respectively associated with this debt. At March 31, 2020, our outstanding debt balance was \$186.0 million based on 5.98% effective interest rate during the period. See above Note 7 “Long-term Debt” for additional information regarding our debt.

### ***Provision for Income Taxes***

The provision for income taxes was an \$870 thousand and \$1.1 million benefit for the three month periods ended March 31, 2020 and 2019, respectively. The operating losses incurred by the Company’s U.S. operations in past years and the resulting net operating losses for U.S. Federal income tax purposes are subject to a \$22.9 million reserve because of the uncertainty of future taxable income levels sufficient to utilize our net operating losses and credits. Our March 31, 2020, provision benefit of \$870 thousand included \$633 thousand in deferred taxes, and a \$337 thousand tax benefit related to the return of federal Alternative Minimum Tax credits, all of which is offset by \$100 thousand in state taxes then payable based on gross revenues. Our March 31, 2019, provision benefit of \$1.1 million includes \$1.1 million in deferred taxes, an \$85 thousand benefit related to the return of federal Alternative Minimum Tax credits, and \$41 thousand in taxes related to our Canadian operations.

No tax penalty-related charges were accrued or recognized for the three month periods ended March 31, 2020 and 2019. Additionally, we have not taken a tax position that would have a material effect on our financial statements or our effective tax rate for the three-month period ended March 31, 2020. We are currently subject to a three-year statute of limitations by major tax jurisdictions.

At March 31, 2020, the Company partially reserved its U.S. net deferred tax assets due to the uncertainty of future taxable income being sufficient to utilize net loss carryforwards prior to their expiration, as noted above. The Company did not reserve \$37.2 million of its U.S. net deferred tax assets. The majority of this unreserved portion related to \$33.0 million in U.S. net operating losses (“NOLs”) because we believe the Company will generate sufficient taxable income in future years to utilize these NOLs prior to their expiration. The remaining balance consists of \$3.4 million relating to temporary differences between GAAP and tax-related expense and \$771 thousand relating to U.S. state income tax credits and net operating loss carryovers.

Any reduction to the \$22.9 million valuation allowance related to our deferred tax asset would be based on an assessment of future utilization following accounting guidance, which relies largely on historical earnings. Using this methodology, and updating the future taxable earnings estimates based on first quarter 2020 actual earnings, the Company believes the deferred tax asset allowance as of December 31, 2019, will remain unchanged at December 31, 2020. For this reason, the Company has recognized its first quarter 2019 federal deferred tax provision in full. If in future periods we conclude our future U.S. federal taxable estimate established at the end of the year will exceed the prior year estimate, the Company will offset its federal deferred tax provision by reducing its valuation allowance by an equal amount, thereby eliminating from its deferred tax provision federal taxes from the Company’s financial statements. Significant judgment is required in determining any valuation allowance recorded against the deferred tax asset. In assessing the need for such an allowance, we consider all available evidence, including past operating results, estimates of future taxable income, and the feasibility of tax planning strategies. The Company will continue to reevaluate the need for its valuation allowance each quarter, following the same assessment methodology described above. Adjusting our valuation allowance could have a significant impact on operating results for each period during which it becomes more likely than not that an additional portion of our deferred tax assets will or will not be realized.

We have determined that utilization of existing net operating losses against future taxable income is not currently subject to limitation by Section 382 of the Internal Revenue Code. Future ownership changes, however, may limit the Company’s ability to fully utilize its existing net operating loss carryforwards against future taxable income. The Company currently has U.S. federal net operating loss carryforwards of approximately \$239 million which begin to expire in 2021.

## Net Loss

Our net loss for the three months ended March 31, 2020, of \$853 thousand was an improvement of \$5.4 million compared to our net loss of \$6.3 million for the same period last year. The improvement in our net loss was primarily due to revenue growth and the completion of acquisition related costs associated with our AppRiver purchase, offset by increases in our cost of revenues, research and development, and selling and marketing expenses.

## Liquidity and Capital Resources

### Overview

Based on our performance over the last four quarters and current expectations, including our assessment of the COVID-19 potential impact to our Company, we believe our cash and cash equivalents, cash generated from operations, and availability under our \$25 million Revolving Facility (under which \$8 million was drawn as of March 31, 2020 and the undrawn balance of \$17 million was available to fund working capital and for other general corporate purposes, including the financing of permitted acquisitions, investments, and restricted payments, subject, in both cases, to the conditions contained in the Credit Agreement) will satisfy our working capital needs, capital expenditure requirements, investment requirements, contractual obligations, commitments, and other liquidity requirements associated with our operations through at least the next twelve months. We plan for and measure our liquidity and capital resources through an annual budgeting process and quarterly reviews, and we will continue to monitor our position to protect our Company against uncertainties related to the COVID-19 crisis. During the first three months of 2020, net cash provided by operations was \$4.4 million, an increase of \$4.8 million compared with the \$0.4 million of net cash used by operations in the first three months of 2020. This year over year improvement is attributable to increased spending in the prior year associated with due diligence, banking and other fees related to our AppRiver acquisition in February 2019. At March 31, 2020, our cash and cash equivalents totaled \$16.3 million, an increase of \$2.9 million from the December 31, 2019 balance, and we had outstanding debt of \$186.0 million.

### Sources and Uses of Cash Summary

(In thousands)	Three Months Ended March 31,	
	2020	2019
Net cash provided by (used in) operations	\$ 4,407	\$ (417)
Net cash used in investing activities	\$ (5,007)	\$ (273,448)
Net cash provided by financing activities	\$ 3,466	\$ 263,480

Our primary source of liquidity from our operations is the collection of revenue in advance from our customers and collection of accounts receivable from our customers, net of the timing of payments to our vendors and service providers.

Our investing activities in the first three months of 2020 consisted of \$5 million for capital expenditures, which includes \$3.9 million in capitalized internal-use software and \$1.1 million related to purchases of computer and networking equipment. Our investing activities in the first three months of 2019 consisted of \$271.7 million, net of cash acquired, used in the acquisition of AppRiver and \$1.7 million for capital expenditures, which include \$1.2 million in capitalized internal-use software, and \$0.5 million for computer and networking equipment.

Financing activities in the first three months of 2020 include \$6.0 million drawn from our Revolving Facility and \$117 thousand received from the exercise of stock options. We used \$1.8 million in the repurchase of common stock related to the tax impact of vesting restricted awards, \$460 thousand for principle payments of our long-term debt, and \$406 thousand for payments on our finance leases. Cash received from financing activities in the first three months of 2019 includes \$168.6 million, net of issuance costs, incurred as debt, and \$96.6 million, net of issuance costs, raised through the private purchase of preferred stock. The funding from our debt and preferred stock issuance were used to fund our AppRiver acquisition in February 2019. In addition to these items, we used \$1.3 million to repurchase common stock related to the tax impact of vesting restricted awards, and \$415 thousand for an earn-out payment associated with our acquisition of Greenview Data, Inc.

### Options of Zix Common Stock

We have significant stock options outstanding that are currently vested. There is no assurance that any of these options will be exercised; therefore, the extent of future cash inflow from additional option activity is not certain. The following table summarizes the options that were outstanding as of March 31, 2020. The vested shares are a subset of the outstanding shares. The value of the shares is the number of shares multiplied by the exercise price for each share.

Exercise Price Range	Summary of Outstanding Options			
	Outstanding Options	Total Value of Outstanding Options (In thousands)	Vested Options (included in outstanding options)	Total Value of Vested Options (In thousands)
\$2.00 - \$3.49	247,500	\$ 696	247,500	\$ 696
\$3.50 - \$4.99	462,010	1,755	449,510	1,705
\$8.00 - \$9.50	100,000	803	—	—
Total	809,510	\$ 3,254	697,010	\$ 2,401

### Off-Balance Sheet Arrangements

None.

### Contractual Obligations, Contingent Liabilities and Commitments

We have not entered into any material, non-cancelable purchase commitments at March 31, 2020.

We have severance agreements with certain employees which would require the Company to pay approximately \$6.5 million if all such employees were terminated from employment with our Company following a triggering event (e.g., change of control) as defined in the severance agreements.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We have no material changes to the disclosure on this matter made in our Annual Report on Form 10-K for the year ended December 31, 2019.

### ITEM 4. CONTROLS AND PROCEDURES

The Company, under the supervision and with the participation of its management, including the Chief Executive Officer and the Chief Financial Officer, evaluated the effectiveness of the design and operation of the Company's "disclosure controls and procedures" (as defined in Rule 13a-15(e)) under the Exchange Act as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of March 31, 2020.

### Changes in Internal Controls over Financial Reporting

During the three months ended March 31, 2020, there have been no changes in our internal control over financial reporting that have materially affected or are reasonably likely to materially affect internal control over financial reporting.

## PART II — OTHER INFORMATION

### ITEM 1. Legal Proceedings

We are subject to legal proceedings, claims, and litigation involving our business. While the outcome of these matters is currently not determinable, and the costs and expenses of resolving these matters may be significant, we currently do not expect that the ultimate costs to resolve these matters will have a material adverse effect on our condensed consolidated financial statements.

### ITEM 1A. Risk Factors

See Part I, Item 1A, “Risk Factors,” of the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2019. Except as stated below, as of the date of this report, there have been no material changes in our risk factors from those disclosed in such Annual Report on Form 10-K. The risk factors in our Annual Report on Form 10-K for the fiscal year ended December 31, 2019, and the below should be read in conjunction with the considerations set forth above in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” set forth in our Annual Report on Form 10-K for the fiscal year ended December 31, 2019.

### **We face various risks related to health epidemics, pandemics, and similar outbreaks, which may have material adverse effects on our business, financial position, results of operations and cash flows.**

Our business and financial results may be negatively impacted by health epidemics, pandemics, and similar outbreaks. The recent and rapidly spreading COVID-19 pandemic could have negative impacts on our business, including causing volatility in demand for our products, changes in customer behavior and spending patterns, disruptions in the operations of our third party suppliers and business partners, limitations on our employees’ ability to work and travel, as well as significant changes in the economic and/or political conditions in markets in which we operate. In addition, such a crisis could significantly increase the probability or consequences of the risks of our business faces in ordinary circumstances. Despite our ongoing efforts to manage these impacts, their ultimate effect on us depends on factors beyond our knowledge or control, including the duration and severity of any such outbreak and governmental actions taken to contain the spread and mitigate its public health effects.

### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

- (a) None.
- (b) None.
- (c) Purchases of Equity Securities by the Issuer

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share (1)	Total Number of Shares Purchased as part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs
January 1, 2020 to January 31, 2020	4,035	\$ 6.83	—	\$ —
February 1, 2020 to February 29, 2020	141,042	\$ 7.76	—	\$ —
March 1, 2020 to March 31, 2020	93,067	\$ 7.46	—	\$ —
<b>Total</b>	<b>238,144</b>	<b>\$ 7.62</b>	<b>—</b>	<b>\$ —</b>

- 1 Of the total number of shares purchased for the one month periods ended January 31, 2020, February 29, 2020 and March 31, 2020, 173,537 shares of Restricted Stock, 40,593 shares of Performance Stock, 15,413 units of RSUs and 8,601 units PUs represent shares of Restricted Stock and Performance Stock as well as units of RSUs and PUs withheld by us upon the vesting of outstanding Restricted Stock, Performance Stock, RSUs and PUs. These shares and units were withheld by us to satisfy the minimum statutory tax withholding for the employees for whom Restricted Stock, Performance Stock, RSUs and PUs vested during the period, which is required upon vesting.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5. OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS****a. Exhibits**

The following is a list of exhibits filed as part of this Quarterly Report on Form 10-Q:

Exhibit No.	Description of Exhibits
2.1	<a href="#"><u>Stock Purchase Agreement, dated as of April 2, 2018, by and among Craig Brauff, Julie Lomax Brauff, Shari Wood-Richardson, as Trustee of the Alexandra Brauff Gift Trust U/A 12/21/12, Shari Wood-Richardson, as Trustee of the Courtney Brauff Gift Trust U/A 12/21/12, Julie A. Lomax, as Trustee of the Julie Lomax Gift Trust U/A 12/21/12, and Zix Corporation. Filed as Exhibit 2.1 to Zix Corporation's Current Report on Form 8-K, filed on April 2, 2018, and incorporated herein by reference.</u></a>
2.2	<a href="#"><u>Securities Purchase Agreement, dated as of January 14, 2019, by and among Zix Corporation, AR Topco, LLC, AppRiver Marlin Blocker Corp., AppRiver Holdings, LLC, AppRiver Marlin Topco, L.P., AppRiver Management Holding, LLC, Marlin Equity IV, L.P. and Marlin Topco GP, LLC, as the sellers' representative. Filed as Exhibit 2.2 to Zix Corporation's Annual Report on Form 10-K for the year ended December 31, 2018, and incorporated herein by reference.</u></a>
3.1	<a href="#"><u>Restated Articles of Incorporation of Zix Corporation, as filed with the Texas Secretary of State on November 10, 2005. Filed as Exhibit 3.1 to Zix Corporation's Annual Report on Form 10-K for the year ended December 31, 2005, and incorporated herein by reference.</u></a>
3.2	<a href="#"><u>Second Amended and Restated Bylaws of Zix Corporation, dated November 1, 2016. Filed as Exhibit 3.2 to Zix Corporation's Quarterly Report on Form 10-Q for the quarter ended September 30, 2016, and incorporated herein by reference.</u></a>
3.3	<a href="#"><u>Certificate of Designations of Series A Convertible Preferred Stock, as filed with the Texas Secretary of State on February 15, 2019. Filed as Exhibit 3.1 to Zix Corporation's Current Report on Form 8-K, filed on February 22, 2019, and incorporated herein by reference.</u></a>
3.4	<a href="#"><u>Certificate of Designations of Series B Convertible Preferred Stock, as filed with the Texas Secretary of State on February 15, 2019. Filed as Exhibit 3.2 to Zix Corporation's Current Report on Form 8-K, filed on February 22, 2019, and incorporated herein by reference.</u></a>
31.1*	<a href="#"><u>Certification of David J. Wagner, President and Chief Executive Officer of the Company, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u></a>
31.2*	<a href="#"><u>Certification of David E. Rockvam, Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer) of the Company, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u></a>
32.1**	<a href="#"><u>Certification of CEO and CFO, pursuant to 18 U.S.C. Section 1350, as adopted, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u></a>
101.1*	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 Calculation Linkbase Document 101. LAB Inline XBRL Taxonomy Label Linkbase Document 101. DEF Inline XBRL Taxonomy Linkbase Document 101. PRE Inline XBRL Taxonomy Presentation Linkbase Document
104*	Cover Page Interactive Data File (embedded within the Inline XBRL document).

\* Filed herewith.

\*\* Furnished herewith.

## SIGNATURES

Pursuant to the requirements of 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.

ZIX CORPORATION

Date: May 7, 2020

By: /s/ DAVID E. ROCKVAM  
David E. Rockvam  
*Chief Financial Officer (Principal Financial  
Officer and Principal Accounting Officer)*

## CERTIFICATION

I, David J. Wagner, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Zix Corporation;
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 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 officers 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 7, 2020

/s/ DAVID. J. WAGNER

David J. Wagner

President and Chief Executive Officer

## CERTIFICATION

I, David E. Rockvam, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Zix Corporation;
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 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 officers 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 7, 2020

/s/ DAVID E. ROCKVAM

David E. Rockvam

*Chief Financial Officer (Principal Financial Officer  
and Principal Accounting Officer)*

**CERTIFICATION OF CEO AND CFO PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

May 7, 2020

Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

Ladies and Gentlemen:

The certifications set forth below are being submitted in connection with the Quarterly Report on Form 10-Q (the "Report") of Zix Corporation for the purpose of complying with Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Section 1350 of Chapter 63 of Title 18 of the United States Code.

David J. Wagner, the chief executive officer, and David E. Rockvam, the chief financial officer of Zix Corporation, each certifies that to the best of his knowledge and in the respective capacities as an officer of Zix Corporation:

1. the Report fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act; and
2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Zix Corporation.

/s/ DAVID J. WAGNER

Name: David J. Wagner

Title: President and Chief Executive Officer

/s/ DAVID E. ROCKVAM

Name: David E. Rockvam

Title: Chief Financial Officer