

Guidewire Software, Inc.  
 Form 10-Q  
 March 02, 2016  
Table of Contents

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 January 31, 2016

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
 Commission file number: 001-35394

Guidewire Software, Inc.  
 (Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of Incorporation or organization)	36-4468504 (I.R.S. Employer Identification No.)
---	---

1001 E. Hillsdale Blvd., Suite 800 Foster City, California (Address of principal executive offices)	94404 (Zip Code)
---	---------------------

(650) 357-9100  
 (Registrant's telephone number, including area code)

N/A  
 (Former name, former address and former fiscal year, if changed since last report)

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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted 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 and post such files). Yes  No

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

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

(do not check if a smaller reporting company)

Edgar Filing: Guidewire Software, Inc. - Form 10-Q

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

On January 31, 2016, the registrant had 72,054,151 shares of common stock issued and outstanding.

---

Table of Contents

Guidewire Software, Inc.  
Index

<u>Part I – Financial Information</u>	<u>2</u>
Item 1. <u>Financial Statements (unaudited):</u>	<u>3</u>
<u>Condensed Consolidated Balance Sheets as of January 31, 2016 and July 31, 2015</u>	<u>3</u>
<u>Condensed Consolidated Statements of Operations for the Three and Six Months Ended January 31, 2016 and 2015</u>	<u>4</u>
<u>Condensed Consolidated Statements of Comprehensive Income (Loss) for the Three and Six Months Ended January 31, 2016 and 2015</u>	<u>5</u>
<u>Condensed Consolidated Statements of Cash Flows for the Six Months Ended January 31, 2016 and 2015</u>	<u>6</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>7</u>
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>20</u>
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	<u>33</u>
Item 4. <u>Controls and Procedures</u>	<u>33</u>
<u>Part II – Other Information</u>	<u>35</u>
Item 1. <u>Legal Proceedings</u>	<u>35</u>
Item 1A. <u>Risk Factors</u>	<u>35</u>
Item 6. <u>Exhibits</u>	<u>50</u>
<u>Signatures</u>	<u>51</u>

Table of Contents

FORWARD-LOOKING STATEMENTS

The “Management’s Discussion and Analysis of Financial Condition and Results of Operations” section and other parts of this Quarterly Report on Form 10-Q and certain information incorporated herein by reference contain forward-looking statements within the meaning of the Securities Act of 1933 and the Securities Exchange Act of 1934, which are subject to risks and uncertainties. The forward-looking statements include statements concerning, among other things, our business strategy (including anticipated trends and developments in, and management plans for, our business and the markets in which we operate), financial results, operating results, revenues, gross margins, operating expenses, products, projected costs and capital expenditures, research and development programs, sales and marketing initiatives and competition. In some cases, you can identify these statements by forward-looking words, such as “will,” “may,” “might,” “should,” “could,” “estimate,” “expect,” “suggest,” “believe,” “anticipate,” “intend,” “plan” and the negative or plural of these words and other comparable terminology. Actual events or results may differ materially from those expressed or implied by these statements due to various factors, including but not limited to the matters discussed below, in the section titled “Item 1A. Risk Factors,” and elsewhere in this Quarterly Report on Form 10-Q. Many of the forward-looking statements are located in “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” Examples of forward-looking statements include statements regarding:

- growth prospects of the Property & Casualty (“P&C”) insurance industry and our company;
- trends in our future sales, including seasonality;
- opportunities for growth by technology leadership;
- competitive advantages of our platform of software application solutions;
- our market strategy in relation to our competitors;
- competitive attributes of our software application solutions;
- opportunities to further expand our position outside of the United States;
- our research and development investment and efforts;
- our gross margins and factors that affect gross margins;
- our provision for tax liabilities and other critical accounting estimates;
- our exposure to market risks, and;
- our ability to satisfy future liquidity requirements.

Forward-looking statements are not guarantees of future performance and involve risks and uncertainties. The forward-looking statements contained in this Quarterly Report on Form 10-Q are based on information available to us as of the filing date of this Quarterly Report on Form 10-Q and our current expectations about future events, which are inherently subject to change and involve risks and uncertainties. You should not place undue reliance on these forward-looking statements.

We do not undertake any obligation to update any forward-looking statements in this report or in any of our other communications, except as required by law. All such forward-looking statements should be read as of the time the statements were made and with the recognition that these forward-looking statements may not be complete or accurate at a later date.

---

Unless the context requires otherwise, we are referring to Guidewire Software, Inc. when we use the terms “Guidewire,” the “Company,” “we,” “our” or “us.”



Table of Contents

## PART I – Financial Information

## ITEM 1. Financial Statements (unaudited)

## GUIDEWIRE SOFTWARE, INC. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited, in thousands)

	January 31, 2016	July 31, 2015
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$216,922	\$212,362
Short-term investments	374,022	359,273
Accounts receivable	59,392	62,062
Deferred tax assets, current	—	13,845
Prepaid expenses and other current assets	13,486	14,102
Total current assets	663,822	661,644
Long-term investments	109,820	106,117
Property and equipment, net	13,040	12,160
Intangible assets, net	3,279	3,999
Deferred tax assets, noncurrent	21,430	5,896
Goodwill	9,205	9,205
Other assets	3,681	926
<b>TOTAL ASSETS</b>	<b>\$824,277</b>	<b>\$799,947</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$7,259	\$8,816
Accrued employee compensation	21,990	37,235
Deferred revenues, current	57,796	50,766
Other current liabilities	7,411	7,592
Total current liabilities	94,456	104,409
Deferred revenues, noncurrent	4,167	1,800
Other liabilities	3,762	4,350
Total liabilities	102,385	110,559
<b>STOCKHOLDERS' EQUITY:</b>		
Common stock	7	7
Additional paid-in capital	697,628	662,869
Accumulated other comprehensive loss	(7,881	) (6,343
Retained earnings	32,138	32,855
Total stockholders' equity	721,892	689,388
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$824,277</b>	<b>\$799,947</b>

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

GUIDEWIRE SOFTWARE, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
 (unaudited, in thousands except share and per share amounts)

	Three Months Ended January 31,		Six Months Ended January 31,	
	2016	2015	2016	2015
Revenues:				
License	\$53,376	\$43,655	\$85,716	\$72,475
Maintenance	14,256	12,163	28,269	24,683
Services	34,497	33,628	70,424	72,022
Total revenues	102,129	89,446	184,409	169,180
Cost of revenues:				
License	1,577	1,145	2,741	2,227
Maintenance	2,636	2,271	5,111	4,513
Services	30,688	30,664	62,219	63,111
Total cost of revenues	34,901	34,080	70,071	69,851
Gross profit:				
License	51,799	42,510	82,975	70,248
Maintenance	11,620	9,892	23,158	20,170
Services	3,809	2,964	8,205	8,911
Total gross profit	67,228	55,366	114,338	99,329
Operating expenses:				
Research and development	25,409	22,282	51,081	42,592
Sales and marketing	22,661	20,176	41,952	37,705
General and administrative	11,456	9,573	22,566	19,335
Total operating expenses	59,526	52,031	115,599	99,632
Income (loss) from operations	7,702	3,335	(1,261)	(303)
Interest income	758	495	1,454	1,007
Other income (expense), net	(1,182)	(861)	(965)	(1,344)
Income (loss) before income taxes	7,278	2,969	(772)	(640)
Provision for (benefit from) income taxes	6,365	(1,007)	(55)	(1,619)
Net income (loss)	\$913	\$3,976	\$(717)	\$979
Net income (loss) per share:				
Basic	\$0.01	\$0.06	\$(0.01)	\$0.01
Diluted	\$0.01	\$0.06	\$(0.01)	\$0.01
Shares used in computing net income (loss) per share:				
Basic	71,779,496	69,883,622	71,511,198	69,600,161
Diluted	73,402,064	72,056,861	71,511,198	71,914,972

See accompanying Notes to Condensed Consolidated Financial Statements.

Table of Contents

GUIDEWIRE SOFTWARE, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)  
 (unaudited, in thousands)

	Three Months Ended January 31, 2016		Six Months Ended January 31, 2015	
	2016	2015	2016	2015
	(in thousands)			
Net income (loss)	\$913	\$3,976	\$(717)	\$979
Other comprehensive loss:				
Foreign currency translation adjustments	(1,128)	(2,949)	(1,415)	(4,218)
Unrealized gains (losses) on available-for-sale securities, net of tax benefit (expense) of \$77 and \$(64) for the three months ended January 31, 2016 and 2015, respectively; \$73 and \$(72) for the six months ended January 31, 2016 and 2015, respectively	(73)	101	(123)	134
Reclassification adjustment for realized losses (gains) included in net income (loss)	20	(4)	—	(7)
Other comprehensive loss	(1,181)	(2,852)	(1,538)	(4,091)
Comprehensive income (loss)	\$(268)	\$1,124	\$(2,255)	\$(3,112)

See accompanying Notes to Condensed Consolidated Financial Statements



Table of Contents

GUIDEWIRE SOFTWARE, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (unaudited, in thousands)

	Six Months Ended January 31,	
	2016	2015
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income (loss)	\$(717	) \$979
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	3,542	3,621
Stock-based compensation	31,692	25,486
Excess tax benefit from exercise of stock options and vesting of restricted stock units	(566	) —
Deferred tax assets	(1,703	) (3,459
Amortization of premium on available-for-sale securities	1,838	2,884
Loss on disposals of property and equipment	23	—
Changes in operating assets and liabilities:		
Accounts receivable	2,221	(12,775
Prepaid expenses and other assets	(2,308	) 1,727
Accounts payable	(1,391	) 817
Accrued employee compensation	(14,964	) (13,215
Other liabilities	(121	) 457
Deferred revenues	9,484	(2,455
Net cash provided by operating activities	27,030	4,067
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of available-for-sale securities	(341,990	) (236,841
Sales of available-for-sale securities	321,507	231,895
Purchase of property and equipment	(3,867	) (3,651
Net cash used in investing activities	(24,350	) (8,597
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from issuance of common stock upon exercise of stock options	3,989	3,859
Taxes remitted on RSU awards vested	(1,488	) (17,848
Excess tax benefit from exercise of stock options and vesting of restricted stock units	566	—
Net cash provided by (used in) financing activities	3,067	(13,989
Effect of foreign exchange rate changes on cash and cash equivalents	(1,187	) (4,358
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<b>4,560</b>	<b>(22,877</b>
<b>CASH AND CASH EQUIVALENTS—Beginning of period</b>	<b>212,362</b>	<b>148,101</b>
<b>CASH AND CASH EQUIVALENTS—End of period</b>	<b>\$216,922</b>	<b>\$125,224</b>
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>		
Cash paid for income taxes	\$1,225	\$1,521
<b>SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES:</b>		
Accruals for purchase of property and equipment	\$393	\$145

See accompanying Notes to Condensed Consolidated Financial Statements.



Table of Contents

GUIDEWIRE SOFTWARE, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(unaudited)

1. The Company and Summary of Significant Accounting Policies and Estimates

Business

Guidewire Software, Inc., a Delaware corporation, was incorporated on September 20, 2001. Guidewire Software, Inc., together with its subsidiaries (the “Company”), provides a technology platform which consists of three key elements: core transaction processing, data management and analytics, and digital engagement. It supports core insurance operations, including underwriting and policy administration, claim management and billing, enables new insights into data that can improve business decision making and supports digital sales, service and claims experiences for policyholders, agents, and other key stakeholders. The Company’s customers include insurance carriers for property and casualty insurance.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements and accompanying notes include the Company and its wholly-owned subsidiaries, and reflect all adjustments (all of which are normal and recurring in nature) that, in the opinion of management, are necessary for a fair presentation of the interim periods presented. All inter-company balances and transactions have been eliminated in consolidation. Certain information and note disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”) have been condensed or omitted under the rules and regulations of the Securities and Exchange Commission (“SEC”).

These unaudited interim condensed consolidated financial statements should be read in conjunction with the Company’s financial statements and related notes, together with management’s discussion and analysis of financial condition and results of operations, presented in the Company’s Annual Report on Form 10-K for the fiscal year ended July 31, 2015. There have been no changes in the Company’s significant accounting policies from those that were disclosed in the Company’s consolidated financial statements for the fiscal year ended July 31, 2015 included in the Company’s Annual Report on Form 10-K.

Use of Estimates

The preparation of the accompanying condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions about future events that affect the amounts of assets and liabilities reported, disclosures about contingent assets and liabilities, and reported amounts of revenues and expenses. Significant items subject to such estimates include, but are not limited to, revenue recognition, the useful lives of property and equipment and intangible assets, allowance for doubtful accounts, valuation allowance for deferred tax assets, stock-based compensation, annual bonus attainment, income tax uncertainties, valuation of goodwill and intangible assets, and contingencies. These estimates and assumptions are based on management’s best estimates and judgment. Management regularly evaluates its estimates and assumptions using historical experience and other factors; however, actual results could differ significantly from these estimates.

Cash and Cash Equivalents

Cash and cash equivalents are comprised of cash and highly liquid investments with remaining maturities of 90 days or less at the date of purchase. Cash equivalents consist of commercial paper and money market funds.

Investments

Management determines the appropriate classification of investments at the time of purchase based upon management’s intent with regard to such investments. All investments are held as available-for-sale investments.

The Company classifies investments as short-term when they have remaining contractual maturities of one year or less from the balance sheet date, and as long-term when the investments have remaining contractual maturities of more than one year from the balance sheet date. All investments are recorded at fair value with unrealized holding gains and losses included in accumulated other comprehensive loss.



## Table of Contents

### Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist of cash, cash equivalents, investments and accounts receivable. The Company maintains its cash, cash equivalents and investments with high quality financial institutions. The Company is exposed to credit risk for cash held in financial institutions in the event of a default to the extent that such amounts recorded on the balance sheet are in excess of amounts that are insured by the Federal Deposit Insurance Corporation (“FDIC”).

No customer individually accounted for 10% or more of the Company’s revenues for the three and six months ended January 31, 2016 or 2015. No customer individually accounted for 10% or more of the Company’s total accounts receivable as of January 31, 2016 or as of July 31, 2015.

### Revenue Recognition

The Company enters into arrangements to deliver multiple products or services (multiple-elements). The Company applies software revenue recognition rules and allocates the total revenues among elements based on vendor-specific objective evidence (“VSOE”) of fair value of each element. The Company recognizes revenue on a net basis excluding indirect taxes, such as sales tax and value added tax collected from customers and remitted to government authorities. Revenues are derived from three sources:

- (i) License fees related to term (or time-based) licenses, perpetual software licenses, and other;
- (ii) Maintenance fees related to email and phone support, bug fixes and unspecified software updates and upgrades released when, and if, available during the maintenance term; and
- (iii) Services fees related to professional services related to implementation of our software, reimbursable travel and training.

Revenues are recognized when all of the following criteria are met:

• Persuasive evidence of an arrangement exists. Evidence of an arrangement consists of a written contract signed by both the customer and management prior to the end of the period.

• Delivery or performance has occurred. The Company’s software is delivered electronically to the customer. Delivery is considered to have occurred when the Company provides the customer access to the software along with login credentials.

• Fees are fixed or determinable. The Company assesses whether a fee is fixed or determinable at the outset of the arrangement, primarily based on the payment terms associated with the transaction. Term and perpetual license fees are not considered to be fixed or determinable until they become due. Fees from term licenses are invoiced in annual or quarterly installments over the term of the agreement beginning on the effective date of the license. A significant majority are invoiced annually. Perpetual license fees are generally due between 30 and 60 days from delivery of software, however in certain cases extended payment terms may be offered.

• Collectability is probable. Collectability is assessed on a customer-by-customer basis, based primarily on creditworthiness as determined by credit checks and analysis, as well as customer payment history. Payment terms generally range from 30 to 90 days from invoice date. If it is determined prior to revenue recognition that collection of an arrangement fee is not probable, revenues are deferred until collection becomes probable or cash is collected, assuming all other revenue recognition criteria are satisfied.

• VSOE of fair value does not exist for the Company’s software licenses; therefore, the Company allocates revenues to software licenses using the residual method. Under the residual method, the amount recognized for license fees is the difference between the total fixed and determinable fees and the VSOE of fair value for the undelivered elements under the arrangement.

The VSOE of fair value for elements of an arrangement is based upon the normal pricing and discounting practices for those elements when sold separately. VSOE of fair value for maintenance is established using the stated maintenance renewal rate in the customer’s contract. For term licenses with duration of one year or less, no VSOE of fair value for maintenance exists. VSOE of fair value for services is established if a substantial majority of historical stand-alone selling prices for a service fall within a reasonably narrow price range.

If the undelivered elements are all service elements and VSOE of fair value does not exist for one or more service element, the total arrangement fee is recognized ratably over the longest service period starting at software delivery, assuming all the related services have been made available to the customer.



## Table of Contents

In certain offerings sold as fixed fee arrangements, the Company recognizes services revenues on a proportional performance basis as performance obligations are completed by using the ratio of labor hours to date as an input measure compared to total estimated labor hours for the consulting services.

In cases where professional services are deemed to be essential to the functionality of the software, the arrangement is accounted for using contract accounting until the essential services are complete. If reliable estimates of total project costs can be made, the Company applies the percentage-of-completion method whereby percentage toward completion is measured by using the ratio of service billings to date compared to total estimated service billings for the consulting services. Service billings approximate labor hours as an input measure since they are generally billed monthly on a time and material basis. The fees related to the maintenance are recognized over the period the maintenance is provided.

As noted above, the Company generally invoices fees for licenses and maintenance in annual or quarterly installments payable in advance. Deferred revenues represent amounts, which are billed to or collected from customers for which one or more of the revenue recognition criteria have not been met. The deferred revenues balance does not represent the total contract value of annual or multi-year, non-cancellable arrangements.

### Income Taxes

Income taxes are accounted for under the asset and liability method. Under this method, the Company determines deferred tax assets and liabilities on the basis of the differences between the financial statement carrying amounts of existing assets and liabilities by using enacted tax rates in effect for the year in which the difference is expected to reverse. Deferred tax assets related to excess tax benefits are recorded when utilized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance against deferred tax assets is recorded when it is more likely than not that some portion or all of such deferred tax assets will not be realized and is based on the positive and negative evidence about the future including future reversals of existing taxable temporary differences, projected future taxable income, tax-planning strategies, and results of recent operations.

As described below in Recent Accounting Pronouncements, we adopted ASU 2015-17, Income Taxes: Balance Sheet Classification of Deferred Taxes, effective January 31, 2016 on a prospective basis. As a result, all deferred tax assets and liabilities are classified as non-current as of January 31, 2016. Prior to the adoption, deferred tax assets and liabilities were classified as either current or non-current based on the related asset or liability.

The effective tax rate in any given financial statement period may differ materially from the statutory rate. These differences may be caused by changes in the mix and level of income or losses, changes in the expected outcome of audits, change in tax regulations, or changes in the deferred tax valuation allowance.

The Company records interest and penalties related to unrecognized tax benefits as income tax expense in its condensed consolidated statement of operations.

### Stock-Based Compensation

The Company recognizes compensation expense related to its stock options and restricted stock units (“RSUs”) granted to employees based on the estimated fair value of the awards on the date of grant, net of estimated forfeitures. The awards are subject to time-based vesting, which generally occurs over a period of 4 years. Option awards expire 10 years from the grant date. The Company estimates the grant date fair value, and the resulting stock-based compensation expense, of the Company’s stock options using the Black-Scholes option-pricing model. The Company recognizes the fair value of stock-based compensation for awards which contain only service conditions on a straight-line basis over the requisite service period, which is generally the vesting period of the respective awards. The Company recognizes the compensation cost for awards which contain performance conditions based upon the probability of that performance condition being met, net of estimated forfeitures, using the graded method.

### Recent Accounting Pronouncements

#### Balance Sheet Classification of Deferred Taxes

In November 2015, the FASB issued ASU 2015-17, Income Taxes (Subtopic 740-10) which provides guidance for balance sheet classification of deferred taxes. This ASU requires that deferred tax assets and liabilities be classified as non-current on the balance sheet. The current requirement that deferred tax liabilities and assets of a tax-paying component of an entity be offset and presented as a single amount is not affected by the amendments in this ASU. ASU 2015-17 is effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods with earlier application permitted as of the beginning of an interim or annual reporting period. The amendments in this



Table of Contents

update may be applied either prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented. We adopted this guidance on a prospective basis effective January 31, 2016 and accordingly, classified all deferred taxes as non-current on our balance sheet as of January 31, 2016. Under the prospective method, the prior period balance sheet was not retrospectively adjusted.

## Revenue from Contracts with Customers

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which provides guidance for revenue recognition. This ASU affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of non-financial assets. This ASU will supersede the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance. This ASU also supersedes some cost guidance included in Subtopic 605-35, Revenue Recognition-Construction-Type and Production-Type Contracts. In July 2015, the FASB deferred the effective date to annual reporting periods and interim periods within fiscal years beginning after December 15, 2017. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. The standard will be effective for the Company beginning August 1, 2018 and permits the use of either the retrospective or cumulative effect transition method. We have not yet selected a transition method and continue to evaluate all the potential impacts that this guidance will have on our consolidated financial statements. We have, however, begun modifying the way we engage with customers to reduce the impact we currently believe is likely to occur under the new standard which will be effective in fiscal 2019.

## 2. Fair Value of Financial Instruments

Available-for-sale investments within cash equivalents and investments consist of the following:

	January 31, 2016			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
	(in thousands)			
U.S. agency securities	\$90,429	\$3	\$(45)	) \$90,387
Commercial paper	105,055	5	(5)	) 105,055
Corporate bonds	263,928	61	(320)	) 263,669
U.S. government bonds	87,412	28	(47)	) 87,393
Foreign government bonds	8,598	—	(3)	) 8,595
Money market funds	93,897	—	—	) 93,897
Non-marketable convertible note	\$5,000	\$—	\$—	) \$5,000
Total	\$654,319	\$97	\$(420)	) \$653,996
	July 31, 2015			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
	(in thousands)			
U.S. agency securities	\$82,946	\$21	\$(4)	) \$82,963
Commercial paper	142,822	13	(4)	) 142,831
Corporate bonds	281,942	47	(216)	) 281,773
U.S. government bonds	32,529	13	(2)	) 32,540
Foreign government bonds	8,663	7	(2)	) 8,668
Certificate of deposit	2,700	—	—	) 2,700
Money market funds	88,319	—	—	) 88,319
Total	\$639,921	\$101	\$(228)	) \$639,794

The following table shows the gross unrealized losses and fair value of the Company's investments with unrealized losses, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position:



Table of Contents

	January 31, 2016					
	Less Than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(in thousands)					
Commercial paper	\$28,408	\$(5)	\$—	\$—	\$28,408	\$(5)
U.S. agency securities	77,388	(45)	—	—	77,388	(45)
Corporate bonds	174,470	(320)	—	—	174,470	(320)
U.S. government bonds	53,153	(47)	—	—	53,153	(47)
Foreign government bonds	8,595	(3)	—	—	8,595	(3)
Total	\$342,014	\$(420)	\$—	\$—	\$342,014	\$(420)

As of January 31, 2016, the Company had 121 investments in a gross unrealized loss position. The unrealized losses on its available-for-sale securities were primarily a result of changes in interest rates subsequent to the initial purchase of these securities. The Company does not intend to sell, nor believe it will need to sell, these securities before recovering the associated unrealized losses. The Company does not consider any portion of the unrealized losses at January 31, 2016 to be an other-than-temporary impairment, nor are any unrealized losses considered to be credit losses. The Company has recorded the securities at fair value in its condensed consolidated balance sheets, with unrealized gains and losses reported as a component of accumulated other comprehensive loss. The amounts of realized gains and losses reclassified into earnings are based on the specific identification of the securities sold. The realized gains and losses from sales of securities in the periods presented were not significant.

The following table summarizes the contractual maturities of the Company's investments measured at fair value as of January 31, 2016:

	Less Than 12 Months	12 to 36 Months	Total
	(in thousands)		
U.S. agency securities	\$79,777	\$10,610	\$90,387
Commercial paper	105,055	—	105,055
Corporate bonds	192,698	70,971	263,669
U.S. government bonds	64,154	23,239	87,393
Foreign government bonds	8,595	—	8,595
Money market funds	93,897	—	93,897
Non-marketable convertible note	\$—	\$5,000	\$5,000
Total	\$544,176	\$109,820	\$653,996

**Fair Value Measurement**

The current accounting guidance for fair value measurements defines a three-level valuation hierarchy for disclosures as follows:

Level 1—Unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2—Inputs other than quoted prices included within Level 1 that are observable, unadjusted quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data; and

Level 3—Unobservable inputs that are supported by little or no market activity, which require the Company to develop its own assumptions.

During December 2015, the Company invested \$5 million in a convertible note issued by a privately-held company that does not have a readily determinable market value. The convertible note is recorded in long-term investments on the condensed consolidated balance sheet at fair value. The convertible note is classified within Level 3 as it is valued using significant unobservable inputs or data in an inactive market, and the valuation requires management judgment due to the absence of a



Table of Contents

market price and inherent lack of liquidity. As of January 31, 2016, the carrying value of the convertible note approximated its fair value. The following table summarizes the changes in our Level 3 financial instrument:

	Available-for-Sale Debt Security (in thousands)
Balance as of July 31, 2015	\$—
Purchase	5,000
Sales	—
Balance as of January 31, 2016	\$5,000

The following tables summarize the Company's financial assets measured at fair value on a recurring basis, by level within the fair value hierarchy as of January 31, 2016 and July 31, 2015:

	January 31, 2016			Total
	Level 1 (in thousands)	Level 2	Level 3	
Assets				
Cash and cash equivalents:				
Commercial paper	\$—	\$76,257	\$—	\$76,257
Money market funds	93,897	—	—	93,897
Short-term investments:				
U.S. agency securities	—	79,777	—	79,777
Commercial paper	—	28,798	—	28,798
Corporate bonds	—	192,698	—	192,698
U.S. government bonds	—	64,154	—	64,154
Foreign government bonds	—	8,595	—	8,595
Long-term investments:				
U.S. agency securities	—	10,609	—	10,609
U.S. government bonds	—	23,240	—	23,240
Corporate bonds	—	70,971	—	70,971
Non-marketable convertible note	\$—	\$—	\$5,000	\$5,000
Total assets	\$93,897	\$555,099	\$5,000	\$653,996

Table of Contents

	July 31, 2015			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Assets				
Cash and cash equivalents:				
Commercial paper	\$—	\$86,085	\$—	\$86,085
Money market funds	88,319	—	—	88,319
Short-term investments:				
U.S. agency securities	—	68,212	—	68,212
Commercial paper	—	56,746	—	56,746
U. S. government bonds	—	19,983	—	19,983
Foreign government bonds	—	8,668	—	8,668
Corporate bonds	—	202,964	—	202,964
Certificate of deposit	—	2,700	—	2,700
Long-term investments:				
U.S. agency securities	—	14,751	—	14,751
Corporate bonds	—	78,809	—	78,809
U.S. government bonds	—	12,557	—	12,557
Total assets	\$88,319	\$551,475	\$—	\$639,794

## 3. Balance Sheet Components

## Property and Equipment, Net

Property and equipment consist of the following:

	January 31, 2016	July 31, 2015
	(in thousands)	
Computer hardware	\$17,788	\$15,099
Software	4,146	4,867
Furniture and fixtures	3,283	3,065
Leasehold improvements	8,188	8,040
Total property and equipment	33,405	31,071
Less accumulated depreciation	(20,365)	(18,911)
Property and equipment, net	\$13,040	\$12,160

As of January 31, 2016 and July 31, 2015, no property and equipment was pledged as collateral. Depreciation expense was \$1.4 million and \$2.8 million for the three and six months ended January 31, 2016, respectively, and was \$1.5 million and \$2.9 million for the three and six months ended January 31, 2015, respectively.

## Intangible Assets

Intangible assets consist of the following:

	January 31, 2016	July 31, 2015
	(in thousands)	
Acquired technology:		
Cost	\$7,200	\$7,200
Accumulated amortization	(3,921)	(3,201)
Intangible assets, net	\$3,279	\$3,999

Table of Contents

Amortization expense was \$0.4 million for each of the three months ended January 31, 2016 and 2015, and was \$0.7 million for each of the six months ended January 31, 2016 and 2015. Estimated aggregate amortization expense for each of the next three fiscal years is as follows:

	Future Amortization (in thousands)
Fiscal year ending July 31, 2016 (remainder of fiscal year)	720
2017	1,440
2018	1,119
Total	\$3,279

## Accrued Employee Compensation

Accrued employee compensation consists of the following:

	January 31, 2016 (in thousands)	July 31, 2015
Accrued bonuses	\$9,365	\$19,819
Accrued commission	1,401	5,008
Accrued vacation	7,686	7,980
Accrued salaries, payroll taxes and benefits	3,538	4,428
Total	\$21,990	\$37,235

## Accumulated Other Comprehensive Loss

Changes in accumulated other comprehensive loss by component during the six months ended January 31, 2016 were as follows:

	Foreign Currency Translation Adjustments (in thousands)	Unrealized Gain (Loss) on Available-for-Sale Securities	Total
Balance as of July 31, 2015	\$(6,247	) \$(96	) \$(6,343 )
Other comprehensive gain (loss) before reclassification	(1,415	) (196	) (1,611 )
Amounts reclassified from accumulated other comprehensive loss to earnings	—	—	—
Tax effect	—	73	73
Balance as of January 31, 2016	\$(7,662	) \$(219	) \$(7,881 )

Table of Contents

## 4. Net Income (Loss) Per Share

The following table sets forth the computation of the Company's basic and diluted net income (loss) per share for the periods presented:

	Three Months Ended January 31,		Six Months Ended January 31,	
	2016	2015	2016	2015
	(in thousands, except share and per share amounts)			
Numerator:				
Net income (loss)	\$913	\$3,976	\$(717)	) \$979
Net income (loss) per share:				
Basic	\$0.01	\$0.06	\$(0.01)	) \$0.01
Diluted	\$0.01	\$0.06	\$(0.01)	) \$0.01
Denominator:				
Weighted average shares used in computing net income (loss) per share:				
Basic	71,779,496	69,883,622	71,511,198	69,600,161
Diluted	73,402,064	72,056,861	71,511,198	71,914,972

The following weighted shares outstanding of potential common stock were excluded from the computation of diluted loss per share for the periods presented because including them would have been antidilutive:

	Three Months Ended January 31,		Six Months Ended January 31,	
	2016	2015	2016	2015
Stock options to purchase common stock	77,975	302,569	1,574,949	296,894
Restricted stock units	283	2,250	3,346,340	28,611

## 5. Commitments and Contingencies

There has been no material change in the Company's contractual obligations and commitments other than in the ordinary course of business since the Company's fiscal year ended July 31, 2015. See the Annual Report on Form 10-K for the fiscal year ended July 31, 2015 for additional information regarding the Company's contractual obligations.

## Leases

The Company leases certain facilities and equipment under operating leases. On December 5, 2011, the Company entered into a seven-year lease for a facility to serve as its corporate headquarters, located in Foster City, California, for approximately 97,674 square feet of space which commenced on August 1, 2012. In connection with this lease, the Company opened an unsecured letter of credit with Silicon Valley Bank for \$1.2 million. On July 1, 2015, the unsecured letter of credit was reduced to \$0.4 million in accordance with the lease agreement.

Lease expense for all worldwide facilities and equipment, which is being recognized on a straight-line basis over terms of the various leases, was \$1.4 million and \$2.8 million for the three and six months ended January 31, 2016, respectively, and was \$1.6 million and \$3.2 million for the three and six months ended January 31, 2015, respectively.

## Letters of Credit

The Company had two outstanding letters of credit required to secure contractual commitments and prepayments as of January 31, 2016 and July 31, 2015, respectively. In addition to the unsecured letter of credit for the building lease, the Company had an unsecured letter of credit agreement related to a customer arrangement for Polish Zloty 10.0 million (approximately \$2.5 million as of January 31, 2016) to secure contractual commitments and prepayments. No amounts were outstanding under the Company's unsecured letters of credit as of January 31, 2016 or July 31, 2015.

## Legal Proceedings





Table of Contents

From time to time, the Company is involved in various legal proceedings and receives claims, arising from the normal course of business activities. The Company accrues for estimated losses in the accompanying condensed consolidated financial statements for matters with respect to which the Company believes the likelihood of an adverse outcome is probable and the amount of the loss is reasonably estimable.

**Indemnification**

The Company sells software licenses and services to its customers under contracts (“Software License”). Each Software License contains the terms of the contractual arrangement with the customer and generally includes certain provisions for defending the customer against any claims that the Company’s software infringes upon a patent, copyright, trademark, or other proprietary right of a third party. Software Licenses also indemnify the customer against losses, expenses, and liabilities from damages that may be assessed against the customer in the event the Company’s software is found to infringe upon such third party rights.

The Company has not had to reimburse any of its customers for losses related to indemnification provisions and no material claims against the Company were outstanding as of January 31, 2016 or July 31, 2015. For several reasons, including the lack of prior indemnification claims and the lack of a monetary liability limit for certain infringement cases under various Software Licenses, the Company cannot estimate the amount of potential future payments, if any, related to indemnification provisions.

The Company has also agreed to indemnify its directors and executive officers for costs associated with any fees, expenses, judgments, fines and settlement amounts incurred by any of these persons in any action or proceeding to which any of these persons is, or is threatened to be, made a party by reason of the person’s service as a director or officer, including any action by the Company, arising out of that person’s services as the Company’s director or officer or that person’s services provided to any other company or enterprise at the Company’s request. The Company maintains director and officer insurance coverage that may enable the Company to recover a portion of any future amounts paid.

**6. Stockholders’ Equity and Stock-Based Compensation****Stock-Based Compensation Expense**

Stock-based compensation expense related to stock-based awards is included in the Company’s condensed consolidated statements of operations as follows:

	Three Months Ended January 31,		Six Months Ended January 31,	
	2016	2015	2016	2015
	(in thousands)			
Cost of license revenues	\$103	\$55	\$192	\$104
Cost of maintenance revenues	380	309	719	586
Cost of services revenues	4,673	3,878	9,036	7,391
Research and development	3,911	2,662	7,583	4,805
Sales and marketing	3,616	3,442	7,046	6,429
General and administrative	3,862	3,152	7,116	6,171
Total stock-based compensation expenses	\$16,545	\$13,498	\$31,692	\$25,486

As of January 31, 2016, total unamortized stock-based compensation cost, adjusted for estimated forfeitures, was as follows:

	As of January 31, 2016	
	Unrecognized Expense	Weighted Average Expected Recognition Period
	(in thousands)	(in years)
Stock options	\$3,793	2.0
Restricted stock units	125,456	2.6

\$129,249

Table of Contents

## RSUs

RSU activity under the Company's equity incentive plans is as follows:

	RSUs Outstanding Number of RSUs Outstanding	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value <sup>(1)</sup>
Balance as of July 31, 2015	2,882,674	\$42.65	\$170,222
Granted	1,271,566	\$54.49	
Released	(729,359)	) \$38.72	\$40,230
Canceled	(199,060)	) \$45.10	
Balance as of January 31, 2016	3,225,821	\$48.06	\$177,549
Expected to vest as of January 31, 2016	2,989,088	\$47.80	\$164,519

Aggregate intrinsic value at each period end represents the total market value of RSUs at the Company's closing (1) stock price of \$55.04 and \$59.05 on January 31, 2016 and July 31, 2015, respectively. Aggregate intrinsic value for released RSUs represents the total market value of released RSUs at date of release.

## Stock Options

Stock option activity under the Company's equity incentive plans is as follows:

	Stock Options Outstanding Number of Stock Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value <sup>(1)</sup> (in thousands)
Balance as of July 31, 2015	1,822,062	\$14.29	4.9	\$81,548
Granted	10,000	\$54.00		
Exercised	(346,451)	) \$11.51		\$15,468
Canceled	(20,658)	) \$40.86		
Balance as of January 31, 2016	1,464,953	\$14.85	4.5	\$58,878
Vested and expected to vest as of January 31, 2016	1,455,422	\$14.63	4.5	\$58,810
Exercisable as of January 31, 2016	1,242,275	\$9.49	3.9	\$56,584

Aggregate intrinsic value at each period end represents the difference between the Company's closing stock prices (1) of \$55.04 and \$59.05 on January 31, 2016 and July 31, 2015, respectively, and the exercise price of outstanding options. Aggregate intrinsic value for exercised options represents the difference between the Company's stock price at date of exercise and the exercise price.

## Valuation of Awards

The assumptions used to estimate the grant date fair value of options and the estimated weighted average grant date fair value of options for the six months ended January 31, 2016 and 2015 are as follows:

Table of Contents

	Six Months Ended January 31,	
	2016	2015
Expected life (in years)	4.9	6.0
Risk-free interest rate	1.49%	1.92%
Expected volatility	38.8%	45.1%
Expected dividend yield	—%	—%
Weighted average grant date fair value of options	\$19.18	\$20.53

There were no options granted during the three months ended January 31, 2016 and 2015.

Beginning fiscal year 2016, the Company began estimating the expected term using a historical data method, instead of the simplified method, because it now has sufficient data to estimate the stock option exercise period based on its historical stock option activity and employee termination data. In addition, the Company began estimating the volatility using its own common stock data, instead of volatility of several comparable public listed peers, as the Company now has sufficient trading history of its stock.

#### Common Stock Reserved for Issuance

As of January 31, 2016 and July 31, 2015, the Company was authorized to issue 500,000,000 shares of common stock with a par value of \$0.0001 per share, and 72,054,151 and 71,005,738 shares of common stock were issued and outstanding, respectively. As of January 31, 2016 and July 31, 2015, the Company had reserved shares of common stock for future issuance as follows:

	January 31, 2016	July 31, 2015
Exercise of stock options to purchase common stock	1,464,953	1,822,062
Vesting of restricted stock units	3,225,821	2,882,674
Shares available under stock plans	16,928,044	14,363,906
Total common stock reserved for issuance	21,618,818	19,068,642

#### 7. Income Taxes

The Company recognized an income tax expense of \$6.4 million and an income tax benefit of \$0.1 million for the three and six months ended January 31, 2016, and income tax benefits of \$1.0 million and \$1.6 million for the three and six months ended January 31, 2015, respectively. The effective tax rates of 87.5% and 7.1% for the three and six months ended January 31, 2016 differ from the statutory U.S. federal income tax rate of 35% mainly due to incentive stock options tax deductions, permanent differences for stock-based compensation, the impact of state income taxes, the tax rate differences between the United States and foreign countries, and research and development credits.

The Company provides U.S. income taxes on the earnings of foreign subsidiaries, unless the subsidiaries' earnings are considered indefinitely reinvested outside the United States. As of January 31, 2016, U.S. income taxes were not provided for on the cumulative total of \$31.0 million undistributed earnings from certain foreign subsidiaries. As of January 31, 2016, the unrecognized deferred tax liability for these earnings was approximately \$10.2 million.

During the six months ended January 31, 2016, the decrease in unrecognized tax benefits from the beginning of the period was \$0.9 million. Accordingly, as of January 31, 2016, the Company had unrecognized tax benefits of \$3.9 million that, if recognized, would affect the Company's effective tax rate.

#### 8. Segment Information

The Company operates in one segment. The Company's chief operating decision maker (the "CODM"), its Chief Executive Officer, manages the Company's operations on a consolidated basis for purposes of allocating resources. When evaluating the Company's financial performance, the CODM reviews separate revenues information for the Company's license, maintenance and professional services offerings, while all other financial information is reviewed on a consolidated basis. All of the Company's principal operations and decision-making functions are located in the United States.



Table of Contents

The following table sets forth revenues by country and region based on the billing address of the customer:

	Three Months Ended January 31,		Six Months Ended January 31,	
	2016	2015	2016	2015
	(in thousands)			
United States	\$62,078	\$43,928	\$105,185	\$82,876
Canada	7,091	10,830	16,149	19,217
Other Americas	2,178	2,755	4,627	4,613
Total Americas	71,347	57,513	125,961	106,706
United Kingdom	11,973	11,815	21,660	24,013
Other EMEA	5,303	8,838	12,178	20,627
Total EMEA	17,276	20,653	33,838	44,640
Total APAC	13,506	11,280	24,610	17,834
Total revenues	\$102,129	\$89,446	\$184,409	\$169,180

No country, other than those presented above, accounted for more than 10% of revenues during the three and six months ended January 31, 2016 and 2015, respectively.

The following table sets forth the Company's long-lived assets, including intangibles and goodwill, net by geographic region:

	January 31, 2016	July 31, 2015
	(in thousands)	
Americas	\$22,733	\$22,746
EMEA	2,429	2,183
APAC	362	435
Total	\$25,524	\$25,364

Table of Contents

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

The following discussion and analysis should be read in conjunction with our condensed consolidated financial statements and the notes thereto included elsewhere in this document and the Risk Factors included in Item 1A of Part II of this Quarterly Report on Form 10-Q. All information presented herein is based on our fiscal calendar. Unless otherwise stated, references in this report to particular years or quarters refer to our fiscal years ended in July and the associated quarters of those fiscal years. We do not undertake, and specifically disclaim, any obligation to update any forward-looking statements to reflect the occurrence of events or circumstances after the date of such statements except as required by law.

Overview

We are a leading provider of a software platform for Property and Casualty (“P&C”) insurers that replaces their legacy core systems and transforms their business. Our platform consists of three key elements: core transaction processing, data management and analytics, and digital engagement, which work together to strengthen our customers’ ability to engage and empower their customers, agents, and employees. Our InsuranceSuite™ products provide transactional systems of record, which support the entire insurance lifecycle. Our data management and analytics products enable insurers to manage data more effectively and gain insights that can lead to better business decisions. Our digital engagement products support digital sales, service and claims experiences for policyholders, agents, and other key stakeholders.

We sell our products to a wide variety of global P&C insurance carriers ranging from some of the largest global insurance carriers or their subsidiaries to national carriers to regional carriers. We continue to expand our global reach by growing investments in sales and marketing in Europe, Asia and Latin America. Our customer engagement is led by our direct sales model and supported by our system integrator (“SI”) partners. Customers can buy our software applications, PolicyCenter™, ClaimCenter™ and BillingCenter™, either separately or in combination as a suite. We refer to the combination of all three applications as InsuranceSuite. In addition to our investments in sales and marketing and in our SI partnerships, we work to align with each insurer’s strategic goals in order to address any sales cycle risk. Strong customer relationships are a key driver of our success given the long-term nature of our contracts and the importance of customer references for new sales. We continue to focus on deepening our customer relationships through continued successful product implementations, robust product support, strategic engagement on new products and technologies, and ongoing account management.

Our sales cycles for new and existing customers remain protracted as customers are deliberate and the decision making and product evaluation process is long. Sales to new customers also involve extensive customer due diligence and reference checks. We must also earn credibility as we expand our sales operations and enter new markets which require investment not only in sales and services capabilities, but in development to optimize our products for such new markets.

Our data management and analytics and digital engagement products are sold to customers of InsuranceSuite or one of its component applications, which naturally limits the quantity of potential customers. Some sales of new products are generated at the same time as an insurance carrier becomes a new customer of InsuranceSuite or one of its applications, or are sold later as cross-sell opportunities.

We primarily enter into term based licenses ranging from 2 to 7 years. These contracts are renewable on an annual or multi-year basis. We generally price our licenses based on the amount of direct written premiums (“DWP”) that will be managed by our solutions. We typically invoice our customers annually in advance or, in certain cases, quarterly for both recurring term license and maintenance fees. Our sales and marketing efforts are affected by seasonal variations in which our customer orders are higher in the second and fourth quarters of our fiscal year. We primarily derive our services revenues from implementation, integration and training services. Our implementation teams assist customers in building implementation plans, integrating our software with their existing systems, and defining business rules and requirements unique to each customer.

To extend our technology leadership in the global market, we continue to invest in research and development to enhance and improve our current products and introduce new products to market. Continued investment in product innovation is critical as we seek to: assist our customers in their IT goals; maintain our competitive advantage; grow



our revenues and expand internationally; and meet evolving customer demands.

We partner with leading SIs to assist in the implementation of our products in a manner that increases efficiency and scale while reducing customer implementation costs. Our extensive relationships with SIs and industry partners have strengthened and expanded in line with the interest in and adoption of our products. We encourage our partners to co-market, pursue joint sales initiatives and drive broader adoption of our technology, helping us grow our business more efficiently and focus our engineering resources on continued innovation. Our track record of success with customers and their implementations are

20

---

Table of Contents

central to our strategy. We continue to focus and invest time and resources in increasing the number of qualified consultants employed by our SI partners, develop relationships with new SIs in existing and new markets, and ensure that all partners are ready to assist with implementing our products.

We face a number of risks in the execution of our strategy including risks related to expanding to new markets, managing lengthy sales cycles, competing effectively in the global market, relying on sales to a relatively small number of large customers, developing new products successfully, and increasing the overall adoption of our products. In response to these and other risks we might face, we continue to invest in many areas of our business. Our investments in sales and marketing align with our goal of winning new customers in both existing and new markets, and enable us to maintain a persistent, consultative relationship with our existing customers. Our investments in product development are designed to meet the evolving needs of our customers.

**Seasonality**

We have historically experienced seasonal variations in our revenues as a result of increased customer orders in our second and fourth fiscal quarters. We generally see increased orders in our second fiscal quarter, which is the quarter ended January 31, due to customer buying patterns. We also see increased orders in our fourth fiscal quarter due to efforts by our sales team to achieve annual incentives.

Our services revenues are also subject to seasonal fluctuations, though to a lesser degree than our license revenues. Our services revenues and gross margins are impacted by the number of billable days in a given fiscal quarter while we pay our services professionals the same amounts throughout the year.

**Key Business Metrics**

We use certain key metrics to evaluate and manage our business, including rolling four-quarter recurring revenues from term licenses and total maintenance. In addition, we present select GAAP and non-GAAP financial metrics that we use internally to manage the business and that we believe are useful for investors. These metrics include Adjusted EBITDA and operating cash flow.

**Four-Quarter Recurring Revenues**

We measure four-quarter recurring revenues by adding the total term license revenues and total maintenance revenues recognized in the preceding four quarters ended in the stated period and excluding perpetual license revenues, revenues from perpetual buyout rights and services revenues. This metric allows us to better understand the trends in our recurring revenues because it typically reduces the variations in any particular quarter caused by seasonality, the effects of the annual invoicing of our term licenses and certain effects of contractual provisions that may accelerate or delay revenue recognition in some cases. Our four-quarter recurring revenues for each of the nine periods presented were:

	Four quarters ended								
	January 31, 2016	October 31, 2015	July 31, 2015	April 30, 2015	January 31, 2015	October 31, 2014	July 31, 2014	April 30, 2014	January 31, 2014
	(in thousands)								
Term license revenues	\$184,647	\$173,232	\$169,366	\$160,114	\$157,542	\$150,309	\$139,902	\$125,485	\$115,144
Maintenance revenues	53,610	51,516	50,024	48,785	47,041	44,768	41,888	39,836	38,510
Total four-quarter recurring revenues	\$238,257	\$224,748	\$219,390	\$208,899	\$204,583	\$195,077	\$181,790	\$165,321	\$153,654

**Adjusted EBITDA**

We believe Adjusted EBITDA, a non-GAAP financial measure, is useful in evaluating our operating performance compared to that of other companies in our industry, as this metric generally eliminates the effects of certain items that may vary for different companies for reasons unrelated to overall operating performance. We believe that:

Adjusted EBITDA provides investors and other users of our financial information consistency and comparability with our past financial performance, facilitates period-to-period comparisons of operations and facilitates comparisons with other companies, many of which use similar non-GAAP financial measures to supplement their GAAP results; and

Table of Contents

it is useful to exclude non-cash charges, such as depreciation and amortization and stock-based compensation because the amount of such expenses in any specific period may not directly correlate to the underlying performance of our business operations and these expenses can vary significantly between periods.

We use Adjusted EBITDA in conjunction with traditional GAAP measures as part of our overall assessment of our performance, including the preparation of our annual operating budget and quarterly forecasts, to evaluate the effectiveness of our business strategies and to communicate with our board of directors concerning our financial performance.

Adjusted EBITDA should not be considered as a substitute for other measures of financial performance reported in accordance with GAAP. There are limitations to using non-GAAP financial measures, including that other companies may calculate these measures differently than we do. We compensate for the inherent limitations associated with using Adjusted EBITDA through disclosure of these limitations, presentation of our financial statements in accordance with GAAP and reconciliation of Adjusted EBITDA to the most directly comparable GAAP measure, net income (loss).

The following table provides a reconciliation of net loss to Adjusted EBITDA:

	Three Months Ended January 31,		Six Months Ended January 31,	
	2016	2015	2016	2015
	(in thousands)			
Reconciliation of Adjusted EBITDA:				
Net income (loss)	\$913	\$3,976	\$(717)	\$979
Non-GAAP adjustments:				
Provision for (benefit from) income taxes	6,365	(1,007)	(55)	(1,619)
Interest income	(758)	(495)	(1,454)	(1,007)
Other expense (income), net	1,182	861	965	1,344
Depreciation and amortization	1,751	1,848	3,542	3,621
Stock-based compensation	16,545	13,498	31,692	25,486
Adjusted EBITDA	\$25,998	\$18,681	\$33,973	\$28,804

#### Operating Cash Flows

We monitor our cash flows from operating activities, or operating cash flows, as a key measure of our overall business performance, which enables us to analyze our financial performance without the effects of certain non-cash items such as depreciation and amortization and stock-based compensation expenses. Additionally, operating cash flows takes into account the impact of changes in deferred revenues, which reflects the receipt of cash payment for products before they are recognized as revenues. Our operating cash flows are significantly impacted by timing of invoicing and collections of accounts receivable, annual bonus payment, as well as payments of payroll and other taxes. As a result, our operating cash flows fluctuate significantly on a quarterly basis. Cash provided by operations was \$27.0 million and \$4.1 million for the six months ended January 31, 2016 and 2015, respectively. For a further discussion of our operating cash flows, see “Liquidity and Capital Resources—Cash Flows from Operating Activities.”

#### Critical Accounting Policies and Estimates

Our condensed consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”). Accounting policies, methods and estimates are an integral part of the preparation of condensed consolidated financial statements in accordance with U.S. GAAP and, in part, are based upon management’s current judgments. Those judgments are normally based on knowledge and experience with regard to past and current events and assumptions about future events. Certain accounting policies, methods and estimates are particularly sensitive because of their significance to the condensed consolidated financial statements and because of the possibility that future events affecting them may differ markedly from management’s current judgments. While there are a number of accounting policies, methods and estimates affecting our condensed consolidated financial statements, areas that are particularly significant include:

- Revenue recognition policies;
- Stock-based compensation; and
- Income taxes.



Table of Contents

Other than the adoption of ASU 2015-17 as described in Note 1 of Notes to Condensed Consolidated Financial Statements, there were no significant changes in our critical accounting policies and estimates during the six months ended January 31, 2016. Please refer to Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K filed on September 17, 2015 for a more complete discussion of our critical accounting policies and estimates.

## Results of Operations

The following tables set forth our results of operations for the periods presented. The data has been derived from the unaudited Condensed Consolidated Financial Statements contained in this Quarterly Report on Form 10-Q which, in the opinion of our management, reflect all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the financial position and results of operations for the interim periods presented. The operating results for any period should not be considered indicative of results for any future period. This information should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in our Annual Report on Form 10-K filed with the SEC on September 17, 2015.

	Three Months Ended January 31,		Six Months Ended January 31,	
	2016	2015	2016	2015
	(in thousands)			
Revenues:				
License	\$53,376	\$43,655	\$85,716	\$72,475
Maintenance	14,256	12,163	28,269	24,683
Services	34,497	33,628	70,424	72,022
Total revenues	102,129	89,446	184,409	169,180
Cost of revenues:				
License	1,577	1,145	2,741	2,227
Maintenance	2,636	2,271	5,111	4,513
Services	30,688	30,664	62,219	63,111
Total cost of revenues	34,901	34,080	70,071	69,851
Gross profit:				
License	51,799	42,510	82,975	70,248
Maintenance	11,620	9,892	23,158	20,170
Services	3,809	2,964	8,205	8,911
Total gross profit	67,228	55,366	114,338	99,329
Operating expenses:				
Research and development	25,409	22,282	51,081	42,592
Sales and marketing	22,661	20,176	41,952	37,705
General and administrative	11,456	9,573	22,566	19,335
Total operating expenses	59,526	52,031	115,599	99,632
Income (loss) from operations	7,702	3,335	(1,261)	(303)
Interest income	758	495	1,454	1,007
Other income (expense), net	(1,182)	(861)	(965)	(1,344)
Income (loss) before income taxes	7,278	2,969	(772)	(640)
Provision for (benefit from) income taxes	6,365	(1,007)	(55)	(1,619)
Net income (loss)	\$913	\$3,976	\$(717)	\$979

Table of Contents

	Three Months Ended January 31,		Six Months Ended January 31,		
	2016	2015	2016	2015	
	(percentage of total revenues)				
Revenues:					
License	52	% 49	% 47	% 43	%
Maintenance	14	% 14	% 15	% 15	%
Services	34	% 37	% 38	% 42	%
Total revenues	100	% 100	% 100	% 100	%
Cost of revenues:					
License	1	% 1	% 1	% 1	%
Maintenance	3	% 3	% 3	% 3	%
Services	30	% 34	% 34	% 37	%
Total cost of revenues	34	% 38	% 38	% 41	%
Gross profit:					
License	51	% 48	% 46	% 42	%
Maintenance	11	% 11	% 12	% 12	%
Services	4	% 3	% 4	% 5	%
Total gross profit	66	% 62	% 62	% 59	%
Operating expenses:					
Research and development	25	% 25	% 28	% 25	%
Sales and marketing	22	% 22	% 23	% 22	%
General and administrative	11	% 11	% 12	% 12	%
Total operating expenses	58	% 58	% 63	% 59	%
Income (loss) from operations	8	% 4	% (1)	)% —	%
Interest income	—	% —	% 1	% 1	%
Other income (expense), net	(1)	)% (1)	)% —	% (1)	)%
Income (loss) before income taxes	7	% 3	% —	% —	%
Provision for (benefit from) income taxes	6	% (1)	)% —	% (1)	)%
Net income (loss)	1	% 4	% —	% 1	%

## Revenues

We derive our revenues from licensing our software applications, providing maintenance support and professional services. Our license revenues are primarily generated through annual license fees that recur during the term of our multi-year contracts. These multi-year contracts have licensing terms ranging from 2 to 7 years and are renewable on an annual or multi-year basis. In certain cases, when required by a customer, we license our software on a perpetual basis. In addition, certain of our multi-year term licenses provide the customer with the option to purchase a perpetual license at the end of the initial contract term, which we refer to as a perpetual buyout right. We generally price our licenses based on the amount of direct written premiums, or DWP, that will be managed by our solutions. We typically invoice our customers annually in advance or quarterly for both term license and maintenance fees, and we invoice our perpetual license customers either in full at contract signing or on an installment basis and invoice related maintenance fees annually in advance. Our license revenues have generally been recognized when payment is due from our customers.

Our maintenance revenues are generally recognized over the committed maintenance term. Our maintenance fees are typically priced as a fixed percentage of the associated license fees.

A substantial majority of our services engagements generate revenues on a time and materials basis and revenues are typically recognized upon delivery of our services. We derive our services revenues primarily from implementation services performed for our customers, reimbursable travel expenses and training fees.

Refer to Note 1 of Notes to Condensed Consolidated Financial Statements for a description of our accounting policy related to revenue recognition.



Table of Contents

	Three Months Ended January 31, 2016		2015		Change (\$)	(% )	
	Amount	% of total revenues	Amount	% of total revenues			
	(in thousands, except percentages)						
Revenues:							
License	\$53,376	52	% \$43,655	49	% \$9,721	22	%
Maintenance	14,256	14	% 12,163	14	% 2,093	17	%
Services	34,497	34	% 33,628	37	% 869	3	%
Total revenues	\$102,129	100	% \$89,446	100	% \$12,683	14	%

	Six Months Ended January 31, 2016		2015		Change (\$)	(% )	
	Amount	% of total revenues	Amount	% of total revenues			
	(in thousands, except percentages)						
Revenues:							
License	\$85,716	47	% \$72,475	43	% \$13,241	18	%
Maintenance	28,269	15	% 24,683	15	% 3,586	15	%
Services	70,424	38	% 72,022	42	% (1,598	) (2	)%
Total revenues	\$184,409	100	% \$169,180	100	% \$15,229	9	%

## License Revenues

The \$9.7 million and \$13.2 million increases in license revenues during the three and six months ended January 31, 2016, respectively, were primarily driven by sales of newer products to both new and existing customers and increased adoption of InsuranceSuite. Our license revenues are comprised of term license revenue and perpetual license revenue. Term license remains our predominant licensing model with perpetual comprising less than 10% in each period presented.

	Three Months Ended January 31, 2016		2015		Change (\$)	(% )	
	Amount	% of license revenues	Amount	% of license revenues			
	(in thousands, except percentages)						
License revenues:							
Term	\$52,652	99	% \$41,236	94	% \$11,416	28	%
Perpetual	724	1	% 2,419	6	% (1,695	) (70	)%
Total license revenues	\$53,376	100	% \$43,655	100	% \$9,721	22	%

	Six Months Ended January 31, 2016		2015		Change (\$)	(% )	
	Amount	% of license revenues	Amount	% of license revenues			
	(in thousands, except percentages)						
License revenues:							
Term	\$85,305	100	% \$70,023	97	% \$15,282	22	%

Edgar Filing: Guidewire Software, Inc. - Form 10-Q

Perpetual	411	—	% 2,452	3	% (2,041	) (83	)%
Total license revenues	\$85,716	100	% \$72,475	100	% \$13,241	18	%

Term license revenues increased by \$11.4 million during the three months ended January 31, 2016, as compared to the same quarter a year ago. The increase was the result of a \$6.3 million net increase in revenues recognized primarily due to timing of invoicing and corresponding due dates, early payments made by our customers in the current quarter, and \$5.1 million of revenues recognized for current quarter orders from new and existing customers.

Table of Contents

Term license revenues increased by \$15.3 million during the six months ended January 31, 2016, as compared to the same period a year ago. The increase was the result of \$12.7 million of revenues recognized related to current period orders from new and existing customers, and a net increase of \$2.4 million in revenues recognized primarily due to early payments made by our customers in the current period and incremental growth in our existing customer's direct written premiums as compared to the same period a year ago.

Perpetual license revenues decreased by \$1.7 million and \$2.0 million during the three and six months ended January 31, 2016, respectively, as compared to the same periods a year ago. Decreases in perpetual license revenues were primarily due to fewer perpetual buyouts in the current periods.

We expect perpetual license revenues to continue to account for a small percentage of our total license revenues. However, there may be volatility across quarters for perpetual license revenues, both in absolute terms and as a percentage of total license revenues due to the timing of sales of new perpetual licenses, the timing of annual billings, and the exercise of perpetual buyout rights in term licenses.

**Maintenance Revenues**

The \$2.1 million and \$3.6 million increases in maintenance revenues during the three and six months ended January 31, 2016 reflect our growing customer base and increased license revenues.

We expect that our maintenance revenues will continue to grow as license revenues grow. In the current fiscal year we anticipate that maintenance revenues, since recognized on a ratable basis, will grow more slowly than license revenues due primarily to the delayed impact of negative currency rate movements that affected our maintenance billings in fiscal year 2015.

**Services Revenues**

Services revenues during the three months ended January 31, 2016 increased \$0.9 million as compared to the same quarter a year ago. The increase in services revenues was primarily attributable to more services provided to new and existing customers.

Services revenues during the six months ended January 31, 2016 decreased \$1.6 million, as compared to the same period a year ago, primarily due to the near completion of certain implementation projects and our continued partnership with system integrator partners to assist in the implementation of our products.

We expect our services revenues to decrease as a percentage of total revenues in the current fiscal year as we continue to expand our network of third-party system integrators with whom our customers can contract for services related to our products, although these trends may not be evident in any given quarter as the mix of revenues may fluctuate.

**Deferred Revenues**

	As of January 31, 2016 Amount (in thousands, except percentages)	July 31, 2015 Amount	Change (\$)	(%)	
Deferred revenues:					
Deferred license revenues	\$22,431	\$13,558	\$8,873	65	%
Deferred maintenance revenues	32,400	32,365	35	—	%
Deferred services revenues	7,132	6,643	489	7	%
Total deferred revenues	\$61,963	\$52,566	\$9,397	18	%

The \$8.9 million increase in deferred license revenues compared to the prior fiscal year end was primarily driven by a net increase of \$6.3 million related to billings from existing customer contracts that are being deferred due to invoice timing and corresponding due dates. Additional increases in deferred license revenues resulted from \$2.6 million of license billings related to new contracts executed during the six months ended January 31, 2016 which will be recognized as contractual obligations are met.

Deferred maintenance revenues remained at the same level as the prior fiscal year end.

Table of Contents

The \$0.5 million increase in deferred services revenues compared to the prior fiscal year end was primarily driven by \$2.6 million of services billings deferred due to certain contractual terms, partially offset by \$2.1 million from prior fiscal year billings which were recognized upon fulfillment of certain contractual obligations.

Our deferred revenues consist only of amounts that have been invoiced, but not yet recognized as revenues. As a result, deferred revenues and change in deferred revenues are incomplete measures of the strength of our business and are not necessarily indicative of our future performance.

**Cost of Revenues and Gross Profit**

Our cost of revenues and gross profit are variable and depend on the type of revenues earned in each period. Our cost of license revenues is primarily comprised of royalty fees paid to third parties and fulfillment services personnel costs. Our cost of maintenance revenues is comprised of compensation and benefit expenses for our technical support team, including stock-based compensation, and allocated overhead. Our cost of services revenues is primarily comprised of compensation and benefit expenses for our professional service employees and contractors, including stock-based awards, travel-related costs and allocated overhead.

We allocate overhead such as IT support, facility, and other administrative costs to all functional departments based on headcount. As such, general overhead expenses are reflected in cost of revenue and each functional operating expense category.

	Three Months Ended January 31,		Change		
	2016	2015	(\$)	(%)	
	Amount	Amount			
	(in thousands, except percentages)				
Cost of revenues:					
License	\$1,577	\$1,145	\$432	38	%
Maintenance	2,636	2,271	365	16	%
Services	30,688	30,664	24	—	%
Total cost of revenues	\$34,901	\$34,080	\$821	2	%

## Includes stock-based awards of:

Cost of license revenues	\$103	\$55	\$48		
Cost of maintenance revenues	380	309	71		
Cost of services revenues	4,673	3,878	795		
Total	\$5,156	\$4,242	\$914		

	Six Months Ended January 31,		Change		
	2016	2015	(\$)	(%)	
	Amount	Amount			
	(in thousands, except percentages)				
Cost of revenues:					
License	\$2,741	\$2,227	\$514	23	%
Maintenance	5,111	4,513	598	13	%
Services	62,219	63,111	(892)	(1)	%
Total cost of revenues	\$70,071	\$69,851	\$220	—	%

## Includes stock-based compensation of:

Cost of license revenues	\$192	\$104	\$88		
Cost of maintenance revenues	719	586	133		
Cost of services revenues	9,036	7,391	1,645		
Total	\$9,947	\$8,081	\$1,866		

The \$0.8 million increase in cost of revenues during the three months ended January 31, 2016 was primarily driven by an increase of \$0.9 million in headcount and related costs in addition to an increase of \$0.9 million in stock-based compensation expense due to the issuance of employee equity awards, partially offset by a decrease of \$1.1 million in third-party consultant costs as certain large implementation projects near completion. Our professional service and technical support headcount was 571 at January 31, 2016 compared to 526 at January 31, 2015.

The \$0.2 million increase in cost of revenues during the six months ended January 31, 2016 was primarily driven by an increase of \$2.3 million in headcount and related costs in addition to an increase of \$1.9 million in stock-based compensation

Table of Contents

expense due to the issuance of employee equity awards, partially offset by a decrease of \$4.0 million in third-party consultant costs as certain large implementation projects near completion and our continued partnership with system integrator partners to assist in the implementation of our products..

	Three Months Ended January 31,		2015		Change			
	2016	Margin %	Amount	Margin %	(\$)	(%)		
	(in thousands, except percentages)							
Gross profit:								
License	\$51,799	97	% \$42,510	97	% \$9,289	22		%
Maintenance	11,620	82	% 9,892	81	% 1,728	17		%
Services	3,809	11	% 2,964	9	% 845	29		%
Total gross profit	\$67,228	66	% \$55,366	62	% \$11,862	21		%

	Six Months Ended January 31,		2015		Change			
	2016	Margin %	Amount	Margin %	(\$)	(%)		
	(in thousands, except percentages)							
Gross profit:								
License	\$82,975	97	% \$70,248	97	% \$12,727	18		%
Maintenance	23,158	82	% 20,170	82	% 2,988	15		%
Services	8,205	12	% 8,911	12	% (706 )	(8 )		%
Total gross profit	\$114,338	62	% \$99,329	59	% \$15,009	15		%

Gross profit margin was 66% and 62% for the three and six months ended January 31, 2016, respectively, as compared with 62% and 59% for the three and six months ended January 31, 2015, respectively. The improvements were due to increases in license and maintenance revenues as a percent of total revenues. License and maintenance revenues yield a higher gross margin than our professional services.

We expect our quarterly gross margin to vary in percentage terms as we experience changes in the mix between higher gross margin license revenues and lower gross margin service revenues.

Operating Expenses

Our operating expenses consist of research and development, sales and marketing and general and administrative expenses. The largest components of our operating expenses are compensation and benefit expenses for our employees, including stock-based awards, and, to a lesser extent, professional services costs, rent and facility costs.

Table of Contents

	Three Months Ended January 31, 2016		2015		Change (\$)	Change (%)		
	Amount (in thousands, except percentages)	% of total revenues	Amount	% of total revenues				
Operating expenses:								
Research and development	\$25,409	25	% \$22,282	25	% \$3,127	14	%	
Sales and marketing	22,661	22	% 20,176	22	% 2,485	12	%	
General and administrative	11,456	11	% 9,573	11	% 1,883	20	%	
Total operating expenses	\$59,526	58	% \$52,031	58	% \$7,495	14	%	

Includes stock-based compensation  
of:

Research and development	\$3,911		\$2,662		\$1,249		
Sales and marketing	3,616		3,442		174		
General and administrative	3,862		3,152		710		
Total	\$11,389		\$9,256		\$2,133		

	Six Months Ended January 31, 2016		2015		Change (\$)	Change (%)		
	Amount (in thousands, except percentages)	% of total revenues	Amount	% of total revenues				
Operating expenses:								
Research and development	\$51,081	28	% \$42,592	25	% \$8,489	20	%	
Sales and marketing	41,952	23	% 37,705	22	% 4,247	11	%	
General and administrative	22,566	12	% 19,335	12	% 3,231	17	%	
Total operating expenses	\$115,599	63	% \$99,632	59	% \$15,967	16	%	

Includes stock-based compensation  
of:

Research and development	\$7,583		\$4,805		\$2,778		
Sales and marketing	7,046		6,429		617		
General and administrative	7,116		6,171		945		
Total	\$21,745		\$17,405		\$4,340		

**Research and Development**

Our research and development expenses consist primarily of costs incurred for compensation and benefit expenses for our technical staff, including stock-based awards and allocated overhead, as well as professional services costs.

The \$3.1 million increase in research and development expenses during the three months ended January 31, 2016 was primarily related to the aggregate effect from increased headcount and related expenses, which was partially offset by a decrease in professional services. This included increased expenses from compensation and related headcount costs of \$2.1 million along with an increase in stock-based compensation costs of \$1.2 million. The increase in headcount was primarily a result of our continued investment in data management and analytics, and digital engagement technologies. Our research and development headcount was 415 at January 31, 2016 compared with 361 at January 31, 2015.



The \$8.5 million increase in research and development expenses during the six months ended January 31, 2016 was primarily related to the aggregate effect from increased headcount and related expenses. This included increased expenses from compensation and related headcount costs of \$5.8 million along with an increase in stock-based compensation costs of \$2.8 million.

Table of Contents

We expect our research and development expenses to continue to increase in absolute dollars as we continue to dedicate substantial internal resources to develop, improve and expand the functionality of our solutions.

**Sales and Marketing**

Our sales and marketing expenses consist primarily of costs incurred for compensation and benefit expenses for our sales and marketing employees, including stock-based awards. It also includes allocated overhead, commission payments, travel expenses and professional services for marketing activities.

The \$2.5 million increase in sales and marketing expenses during the three months ended January 31, 2016 was primarily related to the aggregate effect from increased headcount and related expenses, and increased selling expenses. This included increased expenses from compensation and related headcount costs of \$1.4 million and increased costs for stock-based compensation of \$0.2 million. The increased selling expenses of \$0.8 million were related to increased commission expense, resulting from increased customer orders. The increase in headcount was required to support the growth in our revenue base. Our sales and marketing headcount was 244 at January 31, 2016 compared with 224 at January 31, 2015.

The \$4.2 million increase in sales and marketing expenses during the six months ended January 31, 2016 was primarily related to the aggregate effect from increased headcount and related expenses, and increased selling expenses. This included increased expenses from compensation and related headcount costs of \$2.1 million and increased costs for stock-based compensation of \$0.6 million. The increased selling expenses of \$1.3 million were related to increased commission expense, resulting from increased customer orders.

We expect our sales and marketing expenses to continue to increase in absolute dollars as we continue to increase our sales and marketing activities to support business growth.

**General and Administrative**

Our general and administrative expenses consist primarily of compensation and benefit expenses, including stock-based awards, as well as professional services and facility costs related to our executive, finance, human resources, information technology, corporate development and legal functions.

The \$1.9 million increase in general and administrative expenses during the three months ended January 31, 2016 was primarily due to the increased headcount and related costs including stock-based compensation, partially offset by decreased costs for professional services. The increase in headcount was required to support the growth of our business. Our general and administrative headcount was 152 at January 31, 2016 compared with 127 at January 31, 2015.

The \$3.2 million increase in general and administrative expenses during the six months ended January 31, 2016 was primarily due to the increased headcount and related costs including stock-based compensation, and to a lesser extent increase in professional services.

We expect our general and administrative expense to continue to increase in absolute dollars due to increases in personnel costs and infrastructure costs to support the growth of our business.

**Other Income (Expense)**

	Three Months Ended January 31,				
	2016 Amount (in thousands, except percentages)	2015 Amount	Change (\$)	(%)	
Interest income	\$758	\$495	\$263	53	%
Other income (expense), net	\$(1,182)	\$(861)	\$(321)	37	%

	Six Months Ended January 31,				
	2016 Amount (in thousands, except percentages)	2015 Amount	Change (\$)	(%)	

Edgar Filing: Guidewire Software, Inc. - Form 10-Q

Interest income	\$1,454	\$1,007	\$447	44	%
Other income (expense), net	\$(965	) \$(1,344	) \$379	(28	)%

30

---

Table of Contents

## Interest Income

Interest income represents interest earned on our cash, cash equivalents and investments.

Interest income increased by \$0.3 million and \$0.4 million during the three and six months ended January 31, 2016, respectively, due to higher yields on our cash equivalents and investments as well as higher investment balances.

## Other Income (Expense), Net

Other income (expense), net consists primarily of foreign exchange gains (losses) resulting from fluctuations in foreign exchange rates on our receivables and payables denominated in currencies other than the U.S. dollar, mainly British Pound, Euro, Australia and Canadian Dollar, Japanese Yen and Brazilian Real.

We experienced appreciation of the U.S. dollar during each of the periods presented. Other income (expense), net increased by \$0.3 million for the three months ended January 31, 2016 as compared to the same quarter a year ago, primarily due to higher balances denominated in foreign currencies. Other income (expense), net decreased by \$0.4 million for the six months ended January 31, 2016 as compared to the same period a year ago, primarily due to less volatility in U.S. dollar exchange rates, partially offset by higher balances denominated in foreign currencies during the current period.

## Provision for (Benefit from) Income Taxes

We are subject to taxes in the United States as well as other tax jurisdictions or countries in which we conduct business. Earnings from our non-U.S. activities are subject to local country income tax and may be subject to current U.S. income tax.

	Three Months Ended January 31,		Change	
	2016	2015	(\$)	(%)
	Amount	Amount		
	(in thousands, except percentages)			
Provision for (benefit from) income taxes	6,365	(1,007)	) \$7,372	*

	Six Months Ended January 31,		Change	
	2016	2015	(\$)	(%)
	Amount	Amount		
	(in thousands, except percentages)			
Provision for (benefit from) income taxes	\$(55	) \$(1,619	) \$1,564	*

\* Not meaningful

We recognized an income tax expense of \$6.4 million and an income tax benefit of \$0.1 million for the three and six months ended January 31, 2016, respectively, as compared to income tax benefits of \$1.0 million and \$1.6 million for the three and six months ended January 31, 2015, respectively. The change for the three months ended January 31, 2016 was primarily due to increased profitability and decreased benefits from discrete tax items as compared to the same quarter a year ago. The change for the six months ended January 31, 2016 was primarily due to decreased benefits from discrete tax items as compared to the same period a year ago. Our effective tax rates of 87.5% and 7.1% for the three and six months ended January 31, 2016, respectively, differ from the statutory U.S. federal income tax rate of 35% mainly due to incentive stock options tax deductions, permanent differences for stock-based compensation, the impact of state income taxes, the tax rate differences between the United States and foreign countries, and research and development credits.

## Liquidity and Capital Resources

As of January 31, 2016 and July 31, 2015, we had \$700.8 million and \$677.8 million of cash, cash equivalents and investments, respectively, and working capital of \$569.4 million and \$557.2 million, respectively. As of January 31, 2016, approximately \$23.6 million of our cash and cash equivalents were domiciled in foreign tax jurisdictions. While we have no plans to repatriate these funds to the United States in the short term, if we choose to do so, we would be required to accrue and pay additional taxes on any portion of the repatriation where no United States income tax had been previously provided.

Our cash flows from operations are significantly impacted by timing of invoicing and collections of accounts receivable, annual bonus payment, as well as payments of payroll and other taxes. We expect that we will continue to generate positive

Table of Contents

cash flows from operations on an annual basis, although this may fluctuate significantly on a quarterly basis. In particular, we typically use more cash during the first fiscal quarter ended October 31, as we generally pay cash bonuses to our employees for the prior fiscal year during that period and pay seasonally higher sales commissions from increased orders in our fourth fiscal quarter. As such, we believe that our existing cash and cash equivalents and sources of liquidity will be sufficient to fund our operations for at least the next 12 months. Our future capital requirements will depend on many factors, including our rate of revenue growth, the expansion of our sales and marketing activities and the timing and extent of our spending to support our research and development efforts and expansion into other markets. We also anticipate investing in, or acquiring complementary businesses, applications or technologies, which may require the use of significant cash resources and may require incremental financing.

**Cash Flows**

The following summary of cash flows for the periods indicated has been derived from our condensed consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q:

	Six Months Ended January 31,	
	2016	2015
	(in thousands)	
Net cash provided by operating activities	\$27,030	\$4,067
Net cash used in investing activities	\$(24,350	) \$(8,597
Net cash provided by (used in) financing activities	\$3,067	\$(13,989
<b>Cash Flows from Operating Activities</b>		

Net cash provided by operating activities increased by \$23.0 million for the six months ended January 31, 2016 when compared to the six months ended January 31, 2015. We used \$18.4 million less cash for working capital activity as compared to the same period a year ago, primarily due to higher cash collections from customers and changes in deferred revenues as compared to the same period a year ago. This is partially offset by higher bonus, commission, and vendor payments in addition to changes in prepaid and other asset balances compared to the same period a year ago. The increase in operating cash inflow is also attributable to a \$4.6 million increase in profitability after excluding the impact of non-cash charges such as deferred taxes, stock-based compensation, depreciation and amortization expense, and other non-cash items.

**Cash Flows from Investing Activities**

Cash used in investing activities increased by \$15.8 million for the six months ended January 31, 2016, primarily due to a \$10.5 million increase in purchases of marketable securities net of sales proceeds, as compared to the same period a year ago. In the quarter ended January 31, 2016, we purchased a \$5 million non-marketable convertible debt security. All investments are designated as available-for-sale.

**Cash Flows from Financing Activities**

Net cash provided by financing activities was \$3.1 million for the six months ended January 31, 2016, as compared to \$14.0 million net cash used during the same period a year ago. The increase of \$17.1 million in net cash provided by financing activities was due to \$16.4 million less withholding taxes paid for RSU releases, as we switched from the net share settlement to the sell-to-cover tax withholding method in the fourth quarter of fiscal year 2015 for a large majority of the employee population, and a \$0.6 million increase related to the excess tax benefit from the exercise of stock options and vesting of RSUs.

**Contractual Obligations**

Our primary contractual obligations are from operating leases for office space and letters of credit related to those leases. See Note 5 to the Condensed Consolidated Financial Statements for a discussion of our lease commitments and letters of credit.

Other than the lease commitments and letters of credit discussed in Note 5 to the Condensed Consolidated Financial Statements, we do not have commercial commitments under lines of credit, standby repurchase obligations or other such debt arrangements. We do not have any material non-cancellable purchase commitments as of January 31, 2016.

**Off-Balance Sheet Arrangements**

We have no off-balance sheet arrangements or transactions with unconsolidated limited purpose entities, nor do we have any undisclosed material transactions or commitments involving related persons or entities.

32

---

Table of Contents

ITEM 3. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Sensitivity

Our exposure to market risk for changes in interest rates relates primarily to our cash, cash equivalents and investments as of January 31, 2016 and July 31, 2015. Our cash, cash equivalents and investments as of January 31, 2016 and July 31, 2015 were \$700.8 million and \$677.8 million, respectively, consisted primarily of cash, corporate bonds, U. S. agency debt securities, commercial paper, money market funds and municipal debt securities. Our primary exposure to market risk is interest income sensitivity, which is affected by changes in the general level of the interest rates in the United States. However, because of the short-term nature of our interest-bearing securities, a ten percent change in market interest rates would not be expected to have a material impact on our consolidated financial condition or results of operations.

Foreign Currency Exchange Risk

Our results of operations and cash flows are subject to fluctuations due to changes in foreign currency exchange rates, particularly changes in the Canadian dollar, Australian dollar, Euro, British Pound, Japanese Yen and Brazilian Real. The volatility of exchange rates depends on many factors that we cannot forecast with reliable accuracy. Although we believe our operating activities act as a natural hedge for a substantial portion of our foreign currency exposure because we typically collect revenues and incur costs in the currency in the location in which we provide our application, our contracts with our customers are long term in nature so it is difficult to predict if our operating activities will provide a natural hedge in the future. Additionally, changes in foreign currency exchange rates can affect our financial results due to transaction gains or losses related to revaluing certain current asset and current liability balances that are denominated in currencies other than the functional currency of the entities in which they are recorded. For example, for the six months ended January 31, 2016, we experienced 2 to 20 percent fluctuations in exchange rates in Canadian dollar, Australian dollar, Euro, British Pound, Japanese Yen and Brazilian Real and as a result, recorded a foreign currency loss of \$1.0 million as other expense in our statement of operations. We will continue to experience fluctuations in foreign currency exchange rates, and if a ten percent change in foreign exchange rates occurs in the future, a similar impact would result. As our international operations grow, we will continue to reassess our approach to manage our risk relating to fluctuations in currency rates.

Fair Value of Financial Instruments

We do not have material exposure to market risk with respect to investments in financial instruments, as our investments consist primarily of highly liquid investments purchased with a remaining maturity of two years or less. We do not use derivative financial instruments for speculative or trading purposes. However, this does not preclude our adoption of specific hedging strategies in the future.

ITEM 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a- 15(e) and 15d- 15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)), as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on such evaluation, our principal executive officer and principal financial officer have concluded that as of such date, our disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations of Internal Controls

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal controls will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of



the control system are met.

33

---

Table of Contents

Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Table of Contents

PART II – OTHER INFORMATION

ITEM 1. Legal Proceedings

From time to time we are involved in legal proceedings that arise in the ordinary course of our business. Any such proceedings, whether meritorious or not, could be time consuming, costly, and result in the diversion of significant operational resources or management time.

Although the outcomes of legal proceedings are inherently difficult to predict, we are not currently involved in any legal proceeding in which the outcome, in our judgment based on information currently available, is likely to have a material adverse effect on our business or financial position.

ITEM 1A. Risk Factors

A description of the risks and uncertainties associated with our business is set forth below. You should carefully consider such risks and uncertainties, together with the other information contained in this report, and in our other public filings. If any of such risks and uncertainties actually occurs, our business, financial condition or operating results could differ materially from the plans, projections and other forward-looking statements included in the section titled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and elsewhere in this report and in our other public filings. In addition, if any of the following risks and uncertainties, or if any other risks and uncertainties, actually occurs, our business, financial condition or operating results could be harmed substantially, which could cause the market price of our stock to decline, perhaps significantly.

We may experience significant quarterly and annual fluctuations in our results of operations due to a number of factors.

Our quarterly and annual results of operations may fluctuate significantly due to a variety of factors, many of which are outside of our control. This variability may lead to volatility in our stock price as research analysts and investors respond to quarterly fluctuations. In addition, comparing our results of operations on a period-to-period basis, particularly on a sequential quarterly basis, may not be meaningful. You should not rely on our past results as an indication of our future performance.

Factors that may affect our results of operations include:

- the timing of new orders and revenue recognition for new and prior year orders;
- seasonal buying patterns of our customers;
- our ability to increase sales to and renew agreements with our existing customers, particularly larger customers with substantial negotiating leverage, at comparable prices;
- our ability to renew existing contracts for multiple year terms versus annual automatic renewals;
- our ability to attract new customers in both domestic and international markets;
- structure of our licensing contracts, including fluctuations in perpetual licenses from period to period;
- our ability to enter into contracts on favorable terms, including terms related to price, payment timing and product delivery;
- volatility in the sales of our products and timing of the execution of new and renewal agreements within such periods;
- the impact of a recession or any other adverse global economic conditions on our business, including uncertainties that may cause a delay in entering into or a failure to enter into significant customer agreements;
- the lengthy and variable nature of our product implementation cycles;
  - reductions in our customers’ budgets for information technology purchases and delays in their purchasing cycles;
- erosion in services margins or significant increase or decrease in services revenues both in absolute terms and as a percentage of total revenues;
- timing of commissions expense related to large transactions;
- bonus expense based on the bonus attainment rate;
- the timing and cost of hiring personnel and of large expenses such as third-party professional services;
- stock-based compensation expenses, which vary along with changes to our stock price;
- fluctuations in foreign currency exchange rates;

- unanticipated trade sanctions and other restrictions that may impede our ability to sell internationally;
- general domestic and international economic conditions, in the insurance industry in particular; and

35

---

Table of Contents

future accounting pronouncements or changes in accounting rules or our accounting policies.

In addition, our revenue may fluctuate if our customers make an early payment of their annual license fees in advance of the invoice due date. This may cause an unexpected increase in revenues in one quarter which can reduce revenue growth rates in future periods.

The foregoing factors are difficult to forecast, and these, as well as other factors, could materially adversely affect our quarterly and annual results of operations. We believe our ability to adjust spending quickly enough to compensate for a revenues shortfall is very limited and our inability to do so could magnify the adverse impact of such revenues shortfall on our results of operations. If we fail to achieve our quarterly forecasts, if our forecasts fall below the expectations of research analysts or investors, or if our actual results fail to meet the expectations of research analysts or investors, our stock price may decline.

Seasonal sales patterns and other variations related to our revenue recognition may cause significant fluctuations in our results of operations and cash flows and may prevent us from achieving our quarterly or annual forecasts, which may cause our stock price to decline.

We sign a significantly higher percentage of software license orders in the second and fourth quarters of each fiscal year. We generally see increased orders in our second fiscal quarter, which is the quarter ended January 31, due to customer buying patterns. We also see increased orders in our fourth fiscal quarter due to efforts by our sales team to achieve annual incentives. As a result, a significantly higher percentage of our annual license revenues have historically been recognized during those quarters. Since a substantial majority of our license revenues recur annually under our multi-year contracts, we expect to continue to experience this seasonality effect in subsequent years.

Notwithstanding the fact that we generally see increased licensing orders in our second and fourth fiscal quarters, we expect to see additional quarterly revenue fluctuations that may, in some cases, mask the impact of these expected seasonal variations. Our quarterly growth in license revenues also may not match up to new orders we receive in a given quarter. This mismatch is primarily due to the following reasons:

- for the initial year of a multi-year term license, we generally recognize revenues when payment is due and payment may not be due until a subsequent fiscal quarter;

- we may enter into license agreements with future product delivery requirements or specified terms for product upgrades or functionality, which may require us to delay revenue recognition for the initial period;

- our term licenses may include payment terms that are modest at the outset and increase over time; and

- we may enter into license agreements with other contractual terms that may affect the timing of revenue recognition.

Our revenues may fluctuate versus comparable prior periods or prior quarters within the same fiscal year based on when new orders are executed in the quarter and the payment terms of each order. Additionally, our revenues may fluctuate if our customers make an early payment of their annual license fees in advance of the invoice due date. Our ability to renew existing contracts for multiple year terms versus annual automatic renewals may also impact revenue recognition.

We generally charge annual software license fees for our multi-year term licenses and price our licenses based on the amount of direct written premiums (“DWP”) that will be managed by our solutions. However, in certain circumstances, our customers desire the ability to purchase our products on a perpetual license basis, resulting in an acceleration of revenue recognition. Milestone payments in a perpetual license order also cause seasonal variations. Our perpetual license revenues are not consistent from period to period. In addition, a few of our multi-year term licenses provide the customer with the option to purchase a perpetual license at the end of the initial contract term, which we refer to as a perpetual buyout right. The mix of our contract terms for our licenses and the exercise of perpetual buyout rights at the end of the initial contract term by our customers may lead to variability in our results of operations. Increases in perpetual license sales and exercises of perpetual buyout rights by our customers may affect our ability to show consistent growth in license revenues in subsequent periods. Reductions in perpetual licenses in future periods could cause adverse period-to-period comparisons of our financial results.

In addition, because we price our products based on the amount of DWP that will be managed by our solutions, license revenues from each customer may fluctuate up or down based upon insurance policies sold by the customer in the preceding year. If we enter into a new territory, our revenue recognition pattern may change, depending on the contractual terms and local laws and regulations. Seasonal and other variations related to our revenue recognition may

cause significant fluctuations in our results of operations and cash flows, may make it challenging for an investor to predict our performance on a quarterly basis and may prevent us from achieving our quarterly or annual forecasts or meeting or exceeding the expectations of research analysts or investors, which may cause our stock price to decline.

Table of Contents

We have relied and expect to continue to rely on orders from a relatively small number of customers in the P&C insurance industry for a substantial portion of our revenues, and the loss of any of these customers would significantly harm our business, results of operations and financial condition.

Our revenues are dependent on orders from customers in the P&C insurance industry, which may be adversely affected by economic, environmental and world political conditions. A relatively small number of customers have historically accounted for a significant portion of our revenues. While the composition of our individual top customers will vary from year to year, in fiscal years 2015, 2014 and 2013, our ten largest customers accounted for 31%, 35% and 33% of our revenues, respectively. While we expect this reliance to decrease over time, we expect that we will continue to depend upon a relatively small number of customers for a significant portion of our revenues for the foreseeable future. As a result, if we fail to successfully sell our products and services to one or more anticipated customers in any particular period or fail to identify additional potential customers or an anticipated customer purchases fewer of our products or services, defers or cancels orders, fails to renew its license agreements or terminates its relationship with us, our business, results of operations and financial condition would be harmed. Some of our orders are realized at the end of the quarter or are subject to delayed payment terms. As a result of this concentration and timing, if we are unable to complete one or more substantial sales or achieve any required performance or acceptance criteria in any given quarter, our quarterly results of operations may fluctuate significantly. Increases in services revenues as a percentage of total revenues or lower services margins could adversely affect our overall gross margins and profitability.

Our services revenues were 40%, 45% and 46% of total revenues for each of fiscal years 2015, 2014 and 2013, respectively. Our services revenues produce lower gross margins than our license revenues. The gross margin of our services revenues was 12%, 13% and 16% for fiscal years 2015, 2014 and 2013, respectively, while the gross margin for license revenues was 97%, 97% and 99% for the respective periods. An increase in the percentage of total revenues represented by services revenues or lower services margins could reduce our overall gross margins and adversely affect our results of operations. These trends can be the result of several factors, some of which are outside of our control, including the rates we charge for our services and the utilization of our personnel, unexpected difficulty in projects which may require additional efforts without commensurate compensation and the extent to which system integrators provide services directly to customers. Any erosion in our services margins or any significant increase in services revenues as a percentage of total revenues would adversely affect our results of operations.

Assertions by third parties of infringement or other violation by us of their intellectual property rights could result in significant costs and substantially harm our business and results of operations.

The software industry is characterized by the existence of a large number of patents and frequent claims and related litigation regarding patents and other intellectual property rights. In particular, leading companies in the software industry own large numbers of patents, copyrights, trademarks and trade secrets, which they may use to assert claims against us. From time to time, third parties, including certain of these leading companies, may assert patent, copyright, trademark or other intellectual property claims against us, our customers and partners, and those from whom we license technology and intellectual property.

Although we believe that our products and services do not infringe upon the intellectual property rights of third parties, we cannot assure that third parties will not assert infringement or misappropriation claims against us with respect to current or future products or services, or that any such assertions will not require us to enter into royalty arrangements or result in costly litigation, or result in us being unable to use certain intellectual property. We cannot assure that we are not infringing or otherwise violating any third-party intellectual property rights. Infringement assertions from third parties may involve patent holding companies or other patent owners who have no relevant product revenues, and therefore our own issued and pending patents may provide little or no deterrence to these patent owners in bringing intellectual property rights claims against us.

If we are forced to defend against any infringement or misappropriation claims, whether they are with or without merit, are settled out of court, or are determined in our favor, we may be required to expend significant time and financial resources on the defense of such claims. Furthermore, an adverse outcome of a dispute may require us to pay damages, potentially including treble damages and attorneys' fees, if we are found to have willfully infringed a party's intellectual property; cease making, licensing or using our products or services that are alleged to infringe or

misappropriate the intellectual property of others; expend additional development resources to redesign our products or services; enter into potentially unfavorable royalty or license agreements in order to obtain the right to use necessary technologies or works; and to indemnify our partners, customers, and other third parties. Any of these events could seriously harm our business, results of operations and financial condition.

We may expand through acquisitions or partnerships with other companies, which may divert our management's attention and result in unexpected operating and technology integration difficulties, increased costs and dilution to our stockholders.



Table of Contents

Our business strategy includes the potential acquisitions of the shares or assets of companies with complementary software, technologies or businesses or alliances with such companies. Acquisitions and alliances may result in unforeseen operating difficulties and expenditures and may not result in the benefits anticipated by such corporate activity. In particular, we may fail to: assimilate or integrate the businesses, technologies, services, products, personnel or operations of the acquired companies; retain key personnel necessary to favorably execute the combined companies business plan; retain existing customers or sell acquired products to new customers. Acquisitions and alliances may also disrupt our ongoing business, divert our resources and require significant management attention that would otherwise be available for ongoing development of our current business. We also may be required to use a substantial amount of our cash or issue debt or equity securities to complete an acquisition or realize the potential of an alliance, which could deplete our cash reserves and/or dilute our existing stockholders. Following an acquisition or the establishment of an alliance offering new products, we may be required to defer the recognition of revenues that we receive from the sale of products that we acquired or that result from the alliance, or from the sale of a bundle of products that includes such new products, if we have not established vendor-specific objective evidence (“VSOE”) for the undelivered elements in the arrangement. In addition, our ability to maintain favorable pricing of new products may be challenging if we bundle such products with sales of existing products. A delay in the recognition of revenues from sales of acquired or alliance products, or reduced pricing due to bundled sales, may cause fluctuations in our quarterly financial results, may adversely affect our operating margins and may reduce the benefits of such acquisitions or alliances.

Additionally, competition within the software industry for acquisitions of businesses, technologies and assets has been, and may in the future continue to be, intense. As such, even if we are able to identify an acquisition that we would like to consummate, the target may be acquired by another strategic buyer or financial buyer such as a private equity firm, or we may otherwise not be able to complete the acquisition on commercially reasonable terms, if at all. Moreover, in addition to our failure to realize the anticipated benefits of any acquisition, including our revenues or return on investment assumptions, we may be exposed to unknown liabilities or impairment charges as a result of acquisitions we do complete.

We face intense competition in our market, which could negatively impact our business, results of operations and financial condition and cause our market share to decline.

The market for our core insurance system software is intensely competitive. We compete with legacy systems, many of which have been in operation for decades. Maintaining these legacy systems may be so time consuming and costly for our customers that they do not have adequate resources to devote to the purchase and implementation of our products. Our implementation cycle is lengthy, variable and requires the investment of significant time and expense by our customers. We also compete against technology consulting firms that offer software and systems or develop custom, proprietary products for the P&C insurance industry. These consulting firms generally have greater name recognition, larger sales and marketing budgets and greater resources than we do and may have pre-existing relationships with our potential customers, including relationships with, and access to, key decision makers within these organizations. Since sales of software products may be a small part of their business and they may be more focused on related services revenues, they may offer their software products at significantly reduced prices or under terms that we cannot match. The competitors we face in any sale may change depending, among other things, on the line of business purchasing the software, the application being sold, the geography in which we’re operating and the size of the insurance carrier to which we are selling. For example, we are more likely to face competition from small independent firms when addressing the needs of small insurers. These competitors compete on the basis of price, the time and cost required for software implementation, custom developments, or unique product features or functions. Outside of the United States, we are more likely to compete against vendors that may differentiate themselves based on local advantages in language, market knowledge and pre-built content applicable to that jurisdiction. We also compete with vendors of horizontal software products that may be customized to address needs of the P&C insurance industry.

We expect the intensity of competition to remain high in the future as existing companies obtain new capital, consolidate with other vendors or develop stronger capabilities or as new companies enter our markets. Such intense competition could result in increased pricing pressure, reduced profit margins, increased sales and marketing

expenses, and failure to increase, or the loss of, market share, any of which could harm our business, results of operations, financial condition or future prospects. Our larger competitors may be able to devote greater resources to the development, promotion and sale of their products than we can devote to ours, which could allow them to respond more quickly than we can to new technologies and changes in customer needs leading to wider market acceptance. We may not be able to compete effectively and competitive pressures may prevent us from acquiring and maintaining the customer base necessary for us to increase our revenues and profitability.

Our current and potential competitors may also establish cooperative relationships among themselves or with third parties that may further enhance their resources. Current or potential competitors may be acquired by other vendors or third parties with greater available resources. As a result of such acquisitions, our current or potential competitors might be more able than we to adapt more quickly to new technologies and customer needs, devote greater resources to the promotion or sale of their products and services, initiate or withstand substantial price competition, or take advantage of other opportunities to more readily or develop and expand their product and service offerings more quickly. Additionally, they may hold larger portfolios of

Table of Contents

patents and other intellectual property rights as a result of such acquisitions. If we are unable to compete effectively for a share of our market, our business, results of operations and financial condition could be materially and adversely affected.

If our products or cloud-based services experience data security breaches, and there is unauthorized access to our customers' data, we may lose current or future customers and our reputation and business may be harmed.

If our security measures are breached or unauthorized access to customer data is otherwise obtained, our products may be perceived as not being secure, customers may reduce the use of or stop using our products, and we may incur significant liabilities. Our software and cloud services involve the storage and transmission of data, and security breaches could result in the loss of this information, litigation, indemnity obligations and other liability. While we have taken steps to protect the confidential information that we have access to, including confidential information we may obtain through our customer support services or customer usage of our cloud-based services, our security measures could be breached. Because techniques used to obtain unauthorized access or sabotage systems change frequently and generally are not identified until they are launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. Any or all of these issues could negatively impact our ability to attract new customers and increase engagement by existing customers, cause existing customers to elect to not renew their term licenses, or subject us to third-party lawsuits, regulatory fines or other action or liability, thereby adversely affecting our financial results. We use third-party technology and systems for a variety of reasons, including, without limitation, encryption and authentication technology, employee email, content delivery to customers, back-office support and other functions. Although we have developed systems and processes that are designed to protect customer information and prevent data loss and other security breaches, including systems and processes designed to reduce the impact of a security breach at a third-party vendor, such measures cannot provide absolute security.

Privacy concerns could result in regulatory changes and impose additional costs and liabilities on us, limit our use of information, and adversely affect our business.

Guidewire's current and predominant business model does not significantly collect and transfer personal information from our customers to Guidewire, however, a limited number of our product solutions may collect, process, store, and use transaction-level data aggregated across insurers using Guidewire's common data model. We anticipate that over time we may expand our business model to include greater collection and transfer of personal information from our customers to Guidewire and we recognize that personal privacy has become a significant issue in the United States, Europe, and many other countries where we operate. Many federal, state, and foreign legislatures and government agencies have imposed or are considering imposing restrictions and requirements about the collection, use, and disclosure of personal information.

In the European Community, Directive 95/46/EC (the "Directive") has required European Union member states to implement data protection laws to meet the strict privacy requirements of the Directive. Among other requirements, the Directive regulates transfers of personally identifiable data that is subject to the Directive ("Personal Data") to third countries, such as the United States, that have not been found to provide adequate protection to such Personal Data.

We have in the past relied upon adherence to the U.S. Department of Commerce's Safe Harbor Privacy Principles and compliance with the U.S.-EU and U.S.-Swiss Safe Harbor Frameworks as agreed to and set forth by the U.S.

Department of Commerce, and the European Union and Switzerland, which established a means for legitimating the transfer of Personal Data collected by US companies doing business in the European Economic Area (or "EEA"), to the U.S. As a result of the October 6, 2015 European Union Court of Justice, or ECJ, opinion in Case C-362/14 (Schrems v. Data Protection Commissioner) regarding the adequacy of the U.S.-EU Safe Harbor Framework, the U.S.-EU Safe Harbor Framework is no longer deemed to be a valid method of compliance with requirements set forth in the Directive (and member states' implementations thereof) regarding the transfer of Personal Data outside of the EEA. Recently, it was announced that negotiators from the EU and US reached political agreement on a successor to the Safe Harbor framework that will be referred to as the EU-US Privacy Shield. However, it is likely to be months before all of the details regarding the Privacy Shield program are finalized and a procedure is introduced to allow interested companies to participate in the program. While the details regarding the Privacy Shield program continue to be finalized, we will continue to face uncertainty to the limited extent we may transfer any Personal Data and as to

whether our efforts to comply with our obligations under European privacy laws will be sufficient. If we are investigated by a European data protection authority, we could face fines and other penalties. Any such investigation or charges by European data protection authorities could have a negative effect on our existing business and on our ability to attract and retain new customers.

In light of the ECJ opinion in the Schrems case, we have begun to undertake efforts in the event of any necessary transfers of Personal Data from the EEA based on current regulatory obligations, available guidance of data protection authorities, and evolving best practices. Despite this, we may be unsuccessful in conforming to means of transferring such data from the EEA, including due to ongoing legislative activity, which may vary the current data protection landscape for the transfer of Personal Data.

Table of Contents

We may also experience hesitancy, reluctance, or refusal by European or multi-national customers to continue to use some of our services due to the potential risk exposure to such customers as a result of the ECJ ruling in the Schrems case and the current data protection obligations imposed on them by certain data protection authorities. Such customers may also view any alternative approaches to the transfer of any Personal Data as being too costly, too burdensome, too legally uncertain or otherwise objectionable, and therefore may decide not to do business with us if the transfer of Personal Data is a necessary requirement.

Though Guidewire's current and predominant business model does not significantly collect and transfer personal information from our customers to Guidewire, given the current data protection landscape in view of the ECJ opinion in the Schrems case, we may be at risk of potential inquiries and/or enforcement actions taken by certain EU data protection authorities until such point in time that we may be able to ensure that any transfers of Personal Data to us from the EEA are conducted in compliance with all applicable regulatory obligations, the guidance of data protection authorities, and evolving best practices. We may find it necessary to establish systems to maintain Personal Data originating from the EU in the EEA, which may involve substantial expense and may cause us to need to divert resources from other aspects of our business, all of which may adversely affect our business.

The Directive may also be replaced in time with the pending European General Data Protection Regulation, which may impose additional obligations and risk upon our business as we may expand our business model to include greater collection and transfer of personal information from our EEA customers to Guidewire. The pending European General Data Protection Regulation may increase substantially the penalties to which we could be subject in the event of any non-compliance. We may incur substantial expense in complying with the new obligations to be imposed by the European General Data Protection Regulation and we may be required to make significant changes to our expanding business operations, all of which may adversely affect our revenues and our business overall.

Changes to laws or regulations affecting privacy could impose additional costs and liabilities on us and could limit our use of such information to add value for customers. If we were required to change our business activities or revise or eliminate services, or to implement burdensome compliance measures, our business and results of operations could be harmed. In addition, we may be subject to fines, penalties, and potential litigation if we fail to comply with applicable privacy and/or data security laws, regulations, standards and other requirements. The costs of compliance with and other burdens imposed by privacy-related laws, regulations and standards may limit the use and adoption of our product solutions and reduce overall demand.

Furthermore, concerns regarding data privacy and/or security may cause our customers' customers to resist providing the data and information necessary to allow our customers to use our product solutions effectively. Even the perception that the privacy and/or security of personal information is not satisfactorily protected or does not meet applicable legal, regulatory and other requirements could inhibit sales of our products or services, and could limit adoption of our solutions.

Our customers may defer or forego purchases of our products or services in the event of weakened global economic conditions and industry consolidation.

General worldwide economic conditions continue to remain unstable. Prolonged economic uncertainties or downturns could harm our business operations or financial results. These conditions make it difficult for our customers and us to forecast and plan future business activities accurately, and they could cause our customers to reevaluate their decision to purchase our products, which could delay and lengthen our sales cycles or result in cancellations of planned purchases. Furthermore, during challenging economic times our customers may face issues in gaining timely access to sufficient credit, which could result in an impairment of their ability to make timely payments to us. If that were to occur, we may be required to record an allowance for doubtful accounts, which would adversely affect our financial results. A substantial downturn in the P&C insurance industry may cause firms to react to worsening conditions by reducing their capital expenditures in general or by specifically reducing their spending on information technology. P&C insurance companies may delay or cancel information technology projects or seek to lower their costs by renegotiating vendor contracts. Negative or worsening conditions in the general economy both in the United States and abroad, including conditions resulting from financial and credit market fluctuations, could cause a decrease in corporate spending on enterprise software in general, and in the insurance industry specifically, and negatively affect the rate of growth of our business.

The increased pace of consolidation in the P&C insurance industry may result in reduced overall spending on our products. Acquisitions of customers can delay or cancel sales cycles and because we cannot predict the timing or duration of such acquisitions, our results of operations could be materially impacted by the change in the industry. Factors outside of our control including but not limited to natural catastrophes and terrorism may adversely impact the P&C insurance industry, preventing us from expanding or maintaining our existing customer base and increasing our revenues.

Table of Contents

Our customers are P&C insurance carriers which have experienced, and will likely experience in the future, losses from catastrophes or terrorism that may adversely impact their businesses. Catastrophes can be caused by various events, including, amongst others, hurricanes, tsunamis, floods, windstorms, earthquakes, hail, tornadoes, explosions, severe weather and fires. Global warming trends are contributing to an increase in erratic weather patterns globally and intensifying the impact of certain types of catastrophes. Moreover, acts of terrorism or war could cause disruptions in our or our customers' businesses or the economy as a whole. The risks associated with natural catastrophes and terrorism are inherently unpredictable, and it is difficult to predict the timing of such events or estimate the amount of loss they will generate. Future events may adversely impact our current or potential customers, which may prevent us from maintaining or expanding our customer base and increasing our revenues as such events may cause customers to postpone purchases of new products and professional service engagements or discontinue projects.

Our sales and implementation cycles are lengthy and variable, depend upon factors outside our control, and could cause us to expend significant time and resources prior to generating revenues.

The typical sales cycle for our products and services is lengthy and unpredictable, requires pre-purchase evaluation by a significant number of employees in our customers' organizations, and often involves a significant operational decision by our customers. Our sales efforts involve educating our customers about the use and benefits of our products, including the technical capabilities of our products and the potential cost savings achievable by organizations deploying our products. Customers typically undertake a significant evaluation process, which frequently involves not only our products, but also those of our competitors and can result in a lengthy sales cycle. We spend substantial time, effort and money in our sales efforts without any assurance that our efforts will produce any sales. Even if we succeed at completing a sale, we may be unable to predict the size of an initial license until very late in the sales cycle. In addition, we sometimes commit to include specific functions in our base product offering at the request of a customer or group of customers and are unable to recognize license revenues until the specific functions have been added to our products. Providing this additional functionality may be time consuming and may involve factors that are outside of our control.

The implementation and testing of our products by our customers typically lasts 6 to 24 months or longer and unexpected implementation delays and difficulties can occur. Implementing our products typically involves integration with our customers' systems, as well as adding their data to our platform. This can be complex, time consuming and expensive for our customers and can result in delays in the implementation and deployment of our products. Failing to meet the expectations of our customers for the implementation of our products could result in a loss of customers and negative publicity regarding us and our products and services. Such failure could result from our product capabilities or service engagements by us, our system integrator partners or our customers' IT employees, the latter two of which are beyond our direct control. The consequences could include, and have included: monetary credits for current or future service engagements, reduced fees for additional product sales, and a customer's refusal to pay their contractually-obligated license, maintenance or service fees. In addition, time-consuming implementations may also increase the amount of services personnel we must allocate to each customer, thereby increasing our costs and adversely affecting our business, results of operations and financial condition.

The lengthy and variable sales and implementation cycles may have a negative impact on the timing of our revenues, causing our revenues and results of operations to vary significantly from period to period.

If we are unable to continue the successful development of our global direct sales force and the expansion of our relationships with our strategic partners, sales of our products and services will suffer and our growth could be slower than we project.

We believe that our future growth will depend on the continued development of our global direct sales force and their ability to obtain new customers, particularly large P&C insurance carriers, and to manage our existing customer base. Our ability to achieve significant growth in revenues in the future will depend, in large part, on our success in recruiting, training and retaining a sufficient number of global direct sales personnel. New hires require significant training and may, in some cases, take more than a year before becoming productive, if at all. If we are unable to hire and develop sufficient numbers of productive global direct sales personnel, sales of our products and services will suffer and our growth will be impeded.

We believe our future growth also will depend on the expansion of successful relationships with system integrators. Our system integrators as channel partners help us reach additional customers. Our growth in revenues, particularly in international markets, will be influenced by the development and maintenance of this indirect sales channel which, in some cases, may require the establishment of effective relationships with regional systems integrators. Although we have established relationships with some of the leading system integrators, our products and services may compete directly against products and services that such leading system integrators support or market, and in the case of Accenture, own. We are unable to control the quantity or quality of resources that our system integrator partners commit to implementing our products, or the quality or timeliness of such implementation. If our partners do not commit sufficient or qualified resources to these activities, our customers will be less satisfied, be less supportive with references, or may require the investment of our resources at discounted



Table of Contents

rates. These, and other failures by our partners to successfully implement our products, will have an adverse effect on our business and our results of operations could fail to grow in line with our projections.

Our large customers have substantial negotiating leverage, which may require that we agree to terms and conditions that result in increased cost of sales, decreased revenues and lower average selling prices and gross margins, all of which could harm our operating results.

Some of our customers include the largest P&C insurance carriers. These customers have significant bargaining power when negotiating new licenses or renewals of existing licenses, and have the ability to buy similar products from other vendors or develop such systems internally. These customers have and may continue to seek advantageous pricing and other commercial terms and may require us to develop additional features in the products we sell to them. We have and may continue to be required to reduce the average selling price, or increase the average cost, of our products in response to these pressures. If we are unable to avoid reducing our average selling prices or increase our average costs, our results of operations could be harmed.

Because we derive a significant majority of our revenues and cash flows from InsuranceSuite or its component applications - ClaimCenter, PolicyCenter, and BillingCenter products and related services - failure of any of these products or services to satisfy customer demands or to achieve increased market acceptance would harm our business, results of operations, financial condition and growth prospects.

We derive a significant majority of our revenues and cash flows from software licenses, support and services related to our InsuranceSuite product or its individual component applications: ClaimCenter, PolicyCenter and BillingCenter. We expect to continue to derive a substantial portion of our revenues from these sources. As such, increased market acceptance of these products is critical to our continued growth and success. Demand for our products is affected by a number of factors, some of which are beyond our control, including the successful implementation of our products, the timing of development and release of new products by us and our competitors, technological advances which reduce the appeal of our products, and the growth or contraction in the worldwide market for technological solutions for the P&C insurance industry. If we are unable to continue to meet customer demands, to achieve and maintain a technological advantage over competitors, or to achieve more widespread market acceptance of our products, our business, results of operations, financial condition and growth prospects will be materially and adversely affected.

Our business depends on customers renewing and expanding their license and maintenance contracts for our products. A decline in our customer renewals and expansions could harm our future results of operations.

Our customers have no obligation to renew their term licenses after their license period expires, and these licenses may not be renewed on the same or more favorable terms. Moreover, under certain circumstances, our customers have the right to cancel their license agreements before they expire. We have limited historical data with respect to rates of customer license renewals, upgrades and expansions so we may not accurately predict future trends in customer renewals. In addition, our term and perpetual license customers have no obligation to renew their maintenance arrangements after the expiration of the initial contractual period. Our customers' renewal rates may fluctuate or decline because of several factors, including their satisfaction or dissatisfaction with our products and services, the prices of our products and services, the prices of products and services offered by our competitors or reductions in our customers' spending levels due to the macroeconomic environment or other factors. In addition, in some cases, our customers have a right to exercise a perpetual buyout of their term licenses at the end of the initial contract term. If our customers do not renew their term licenses for our solutions or renew on less favorable terms, our revenues may decline or grow more slowly than expected and our profitability may be harmed.

If we are unable to develop, introduce and market new and enhanced versions of our products, we may be put at a competitive disadvantage.

Our success depends on our continued ability to develop, introduce and market new and enhanced versions of our products to meet evolving customer requirements. Because our products are complex and require rigorous testing, development cycles can be lengthy, taking us multiple years to develop and introduce new products or provide updates to our existing products. Additionally, market conditions may dictate that we change the technology platform underlying our existing products or that new products be developed on different technology platforms, potentially adding material time and expense to our development cycles. The nature of these development cycles may cause us to experience delays between the time we incur expenses associated with research and development and the time we

generate revenues, if any, from such expenses.

If we fail to develop new products or enhancements to our existing products, our business could be adversely affected, especially if our competitors are able to introduce products with enhanced functionality. It is critical to our success for us to anticipate changes in technology, industry standards and customer requirements and to successfully introduce new, enhanced and competitive products to meet our customers' and prospective customers' needs on a timely basis. We have invested and

42

---

Table of Contents

intend to increase investments in research and development to meet these challenges. Revenues may not be sufficient to support the future product development that is required for us to remain competitive. If we fail to develop products in a timely manner that are competitive in technology and price or develop products that fail to meet customer demands, our market share will decline and our business and results of operations could be harmed.

Real or perceived errors or failures in our products or implementation services may affect our reputation, cause us to lose customers and reduce sales which may harm our business and results of operations and subject us to liability for breach of warranty claims.

Because we offer complex products, undetected errors or failures may exist or occur, especially when products are first introduced or when new versions are released. Our products are often installed and used in large-scale computing environments with different operating systems, system management software and equipment and networking configurations, which may cause errors or failures in our products or may expose undetected errors, failures or bugs in our products. Despite testing by us, we may not identify all errors, failures or bugs in new products or releases until after commencement of commercial sales or installation. In the past, we have discovered software errors, failures and bugs in some of our product offerings after their introduction.

We provide our customers with upfront estimates regarding the duration, resources and costs associated with the implementation of our products. Failure to meet these upfront estimates and the expectations of our customers could result from our product capabilities or service engagements by us, our system integrator partners or our customers' IT employees, the latter two of which are beyond our direct control. The consequences could include, and have included: monetary credits for current or future service engagements, reduced fees for additional product sales, and a customer's refusal to pay their contractually-obligated license, maintenance or service fees. In addition, time-consuming implementations may also increase the amount of services personnel we must allocate to each customer, thereby increasing our costs and adversely affecting our business, results of operations and financial condition.

The license and support of our software creates the risk of significant liability claims against us. Our license agreements with our customers contain provisions designed to limit our exposure to potential liability claims. It is possible, however, that the limitation of liability provisions contained in such license agreements may not be enforced as a result of international, federal, state and local laws or ordinances or unfavorable judicial decisions. Breach of warranty or damage liability, or injunctive relief resulting from such claims, could harm our results of operations and financial condition.

Failure to protect our intellectual property could substantially harm our business and results of operations.

Our success depends in part on our ability to enforce and defend our intellectual property rights. We rely upon a combination of trademark, trade secret, copyright, patent and unfair competition laws, as well as license agreements and other contractual provisions, to do so.

We have filed, and may in the future file, patent applications related to certain of our innovations. We do not know whether those patent applications will result in the issuance of a patent or whether the examination process will require us to narrow our claims. In addition, we may not receive competitive advantages from the rights granted under our patents and other intellectual property. Our existing patents and any patents granted to us or that we otherwise acquire in the future, may be contested, circumvented or invalidated, and we may not be able to prevent third parties from infringing these patents. Therefore, the extent of the protection afforded by these patents cannot be predicted with certainty. In addition, given the costs, effort, risks and downside of obtaining patent protection, including the requirement to ultimately disclose the invention to the public, we may choose not to seek patent protection for certain innovations; however, such patent protection could later prove to be important to our business.

We also rely on several registered and unregistered trademarks to protect our brand. Nevertheless, competitors may adopt service names similar to ours, or purchase our trademarks and confusingly similar terms as keywords in Internet search engine advertising programs, thereby impeding our ability to build brand identity and possibly leading to confusion in the marketplace. In addition, there could be potential trade name or trademark infringement claims brought by owners of other registered trademarks or trademarks that incorporate variations of our trademarks. Any claims or customer confusion related to our trademarks could damage our reputation and brand and substantially harm our business and results of operations.

We attempt to protect our intellectual property, technology, and confidential information by generally requiring our employees and consultants to enter into confidentiality and assignment of inventions agreements and third parties to enter into nondisclosure agreements, all of which offer only limited protection. These agreements may not effectively prevent unauthorized use or disclosure of our confidential information, intellectual property or technology and may not provide an adequate remedy in the event of unauthorized use or disclosure of our confidential information, intellectual property or technology. Despite our efforts to protect our confidential information, intellectual property, and technology, unauthorized third

Table of Contents

parties may gain access to our confidential proprietary information, develop and market products or services similar to ours, or use trademarks similar to ours, any of which could materially harm our business and results of operations. In addition, others may independently discover our trade secrets and confidential information, and in such cases, we could not assert any trade secret rights against such parties. Existing U.S. federal, state and international intellectual property laws offer only limited protection. The laws of some foreign countries do not protect our intellectual property rights to as great an extent as the laws of the United States, and many foreign countries do not enforce these laws as diligently as governmental agencies and private parties in the United States. Moreover, policing our intellectual property rights is difficult, costly and may not always be effective.

From time to time, legal action by us may be necessary to enforce our patents and other intellectual property rights, to protect our trade secrets, to determine the validity and scope of the intellectual property rights of others or to defend against claims of infringement or invalidity. Such litigation could result in substantial costs and diversion of resources and could negatively affect our business, reputation, results of operations and financial condition. If we are unable to protect our technology and to adequately maintain and protect our intellectual property rights, we may find ourselves at a competitive disadvantage to others who need not incur the additional expense, time and effort required to create the innovative products that have enabled us to be successful to date.

We may be obligated to disclose our proprietary source code to our customers, which may limit our ability to protect our intellectual property and could reduce the renewals of our support and maintenance services.

Our software license agreements typically contain provisions permitting the customer to become a party to, or a beneficiary of, a source code escrow agreement under which we place the proprietary source code for our products in escrow with a third party. Under these escrow agreements, the source code to the applicable product may be released to the customer, typically for its use to maintain, modify and enhance the product, upon the occurrence of specified events, such as our filing for bankruptcy, discontinuance of our maintenance services and breaching our representations, warranties or covenants of our agreements with our customers. Additionally, in some cases, customers have the right to request access to our source code upon demand. Some of our customers have obtained the source code for certain of our products by exercising this right, and others may do so in the future.

Disclosing the content of our source code may limit the intellectual property protection we can obtain or maintain for that source code or the products containing that source code and may facilitate intellectual property infringement claims against us. It also could permit a customer to which a product's source code is disclosed to support and maintain that software product without being required to purchase our support or maintenance services. Each of these could harm our business, results of operations and financial condition.

We and our customers rely on technology and intellectual property of third parties, the loss of which could limit the functionality of our products and disrupt our business.

We use technology and intellectual property licensed from unaffiliated third parties in certain of our products, and we may license additional third-party technology and intellectual property in the future. Any errors or defects in this third-party technology and intellectual property could result in errors that could harm our brand and business. In addition, licensed technology and intellectual property may not continue to be available on commercially reasonable terms, or at all. The loss of the right to license and distribute this third-party technology could limit the functionality of our products and might require us to redesign our products.

Some of our services and technologies may use "open source" software, which may restrict how we use or distribute our services or require that we release the source code of certain products subject to those licenses.

Some of our services and technologies may incorporate software licensed under so-called "open source" licenses, including, but not limited to, the GNU General Public License and the GNU Lesser General Public License. In addition to risks related to license requirements, usage of open source software can lead to greater risks than use of third-party commercial software, as open source licensors generally do not provide warranties or controls on origin of the software. Additionally, open source licenses typically require that source code subject to the license be made available to the public and that any modifications or derivative works to open source software continue to be licensed under open source licenses. These open source licenses typically mandate that proprietary software, when combined in specific ways with open source software, become subject to the open source license. If we combine our proprietary software in such ways with open source software, we could be required to release the source code of our proprietary

software.

We take steps to ensure that our proprietary software is not combined with, and does not incorporate, open source software in ways that would require our proprietary software to be subject to an open source license. However, few courts have interpreted open source licenses, and the manner in which these licenses may be interpreted and enforced is therefore subject to

44

---

## Table of Contents

some uncertainty. Additionally, we rely on multiple software programmers to design our proprietary technologies, and although we take steps to prevent our programmers from including open source software in the technologies and software code that they design, write and modify, we do not exercise complete control over the development efforts of our programmers and we cannot be certain that our programmers have not incorporated open source software into our proprietary products and technologies or that they will not do so in the future. In the event that portions of our proprietary technology are determined to be subject to an open source license, we could be required to publicly release the affected portions of our source code, re-engineer all or a portion of our technologies, or otherwise be limited in the licensing of our technologies, each of which could reduce or eliminate the value of our services and technologies and materially and adversely affect our business, results of operations and prospects.

Incorrect or improper use of our products or our failure to properly train customers on how to utilize our products could result in customer dissatisfaction and negatively affect our business, results of operations, financial condition and growth prospects.

Our products are complex and are deployed in a wide variety of network environments. The proper use of our products requires training of the customer. If our products are not used correctly or as intended, inadequate performance may result. Our products may also be intentionally misused or abused by customers or their employees or third parties who are able to access or use our products. Because our customers rely on our products, services and maintenance support to manage a wide range of operations, the incorrect or improper use of our products, our failure to properly train customers on how to efficiently and effectively use our products, or our failure to properly provide maintenance services to our customers may result in negative publicity or legal claims against us. Also, as we continue to expand our customer base, any failure by us to properly provide these services will likely result in lost opportunities for follow-on sales of our products and services.

In addition, if there is substantial turnover of customer personnel responsible for use of our products, or if customer personnel are not well trained in the use of our products, customers may defer the deployment of our products, may deploy them in a more limited manner than originally anticipated or may not deploy them at all. Further, if there is substantial turnover of the customer personnel responsible for use of our products, our ability to make additional sales may be substantially limited.

Our ability to sell our products is highly dependent on the quality of our professional services and technical support services and the support of our system integration providers, and the failure of us or our system integration providers to offer high-quality professional services or technical support services could damage our reputation and adversely affect our ability to sell our products and services to new customers and renew our licenses to existing customers. If we or our system integration providers do not effectively assist our customers in deploying our products, succeed in helping our customers quickly resolve post-deployment issues, and provide effective ongoing support, our ability to sell additional products and services to existing customers would be adversely affected and our reputation with potential customers could be damaged. Once our products are deployed and integrated with our customers' existing information technology investments and data, our customers may depend on our technical support services and/or the support of system integrators or internal resources to resolve any issues relating to our products. High-quality support is critical for the continued successful marketing and sale of our products. In addition, as we continue to expand our operations internationally, our support organization will face additional challenges, including those associated with delivering support, training and documentation in languages other than English. Many enterprise customers require higher levels of support than smaller customers. If we fail to meet the requirements of our larger customers, it may be more difficult to increase our penetration with larger customers, a key group for the growth of our revenues and profitability. As we rely more on system integrators to provide deployment and on-going services, our ability to ensure a high level of quality in addressing customer issues is diminished. Our failure to maintain high-quality implementation and support services, or to ensure that system integrators provide the same, could have a material adverse effect on our business, results of operations, financial condition and growth prospects.

If we are unable to retain our personnel and hire and integrate additional skilled personnel, we may be unable to achieve our goals and our business will suffer.

Our future success depends upon our ability to continue to attract, train, integrate and retain highly skilled employees, particularly our management team, sales and marketing personnel, professional services personnel and software

engineers. Our inability to attract and retain qualified personnel, or delays in hiring required personnel, may seriously harm our business, results of operations and financial condition.

Each of our executive officers and other key employees could terminate his or her relationship with us at any time. The loss of any member of our senior management team might significantly delay or prevent the achievement of our business or development objectives and could materially harm our business. In addition, a number of our senior management personnel are substantially vested in their stock option grants or other equity compensation. While we periodically grant additional equity awards to management personnel and other key employees to provide additional incentives to remain employed by us,



Table of Contents

employees may be more likely to leave us if a significant portion of their equity compensation is fully vested, especially if the shares underlying the equity awards have significantly appreciated in value.

We face competition for qualified individuals, who are in high demand, from numerous software and other technology companies. Competition for qualified personnel is particularly intense in the San Francisco Bay Area, where our headquarters are located. Often, significant amounts of time and resources are required to train technical, sales and other personnel. We may incur significant costs to attract and retain them, and we may lose new employees to our competitors or other technology companies before we realize the benefit of our investment in recruiting and training them. Also, to the extent we hire personnel from competitors, we may be subject to allegations that they have been improperly solicited or divulged proprietary or other confidential information. We have a limited number of sales people and the loss of several sales people within a short period of time could have a negative impact on our sales efforts. We may be unable to attract and retain suitably qualified individuals who are capable of meeting our growing technical, operational and managerial requirements, or we may be required to pay increased compensation in order to do so.

Our ability to expand geographically depends, in large part, on our ability to attract, retain and integrate both leaders for the local business and people with the appropriate skills. Similarly, our profitability depends on our ability to effectively utilize personnel with the right mix of skills and experience to perform services for our clients, including our ability to transition employees to new assignments on a timely basis. If we are unable to effectively deploy our employees globally on a timely basis to fulfill the needs of our clients, our reputation could suffer and our ability to attract new clients may be harmed.

Because of the technical nature of our products and services and the dynamic market in which we compete, any failure to attract, integrate and retain qualified direct sales, professional services and product development personnel, as well as our contract workers, could harm our ability to generate sales or successfully develop new products, customer and consulting services and enhancements of existing products.

Failure to manage our expanding operations effectively could harm our business.

We have recently experienced rapid growth and expect to continue to expand our operations, among other factors, in the number of employees and in the locations and scope of our international operations. This expansion has placed, and will continue to place, a significant strain on our operational and financial resources and our personnel. To manage our anticipated future operational expansion effectively, we must continue to maintain and may need to enhance our information technology infrastructure, financial and accounting systems and controls and manage expanded operations and employees in geographically distributed locations. Our growth could require significant capital expenditures and may divert financial resources from other projects, such as the development of new products. If we increase the size of our organization without experiencing an increase in sales of our products and services, we will experience reductions in our gross and operating margins and net income. If we are unable to effectively manage our expanding operations, our expenses may increase more than expected, our revenues could decline or grow more slowly than expected and we may be unable to implement our business strategy.

Our international sales and operations subject us to additional risks that can adversely affect our business, results of operations and financial condition.

We sell our products and services to customers located outside the United States and Canada, and we are continuing to expand our international operations as part of our growth strategy. In fiscal years 2015, 2014 and 2013, 35%, 31% and 28% of our revenues, respectively, were derived from outside of the United States and Canada. Our current international operations and our plans to expand our international operations subject us to a variety of risks, including:

- increased management, travel, infrastructure and legal compliance costs associated with having multiple international operations;
- unique terms and conditions in contract negotiations imposed by customers in foreign countries;
- longer payment cycles and difficulties in enforcing contracts and collecting accounts receivable;
- the need to localize our products and licensing programs for international customers;
- lack of familiarity with and unexpected changes in foreign regulatory requirements;
- increased exposure to fluctuations in currency exchange rates;
- the burdens and costs of complying with a wide variety of foreign laws and legal standards;

- compliance with the U.S. Foreign Corrupt Practices Act of 1977, as amended (“FCPA”), the U.K. Bribery Act and other anti-corruption regulations, particularly in emerging market countries;
- compliance by international staff with accounting practices generally accepted in the United States, including adherence to our accounting policies and internal controls;
- import and export license requirements, tariffs, taxes and other trade barriers;

Table of Contents

increased financial accounting and reporting burdens and complexities;  
weaker protection of intellectual property rights in some countries;  
multiple and possibly overlapping tax regimes;  
government sanctions that may interfere with our ability to sell into particular countries, such as Russia; and  
political, social and economic instability abroad, terrorist attacks and security concerns in general.

As we continue to expand our business globally, our success will depend, in large part, on our ability to anticipate and effectively manage these and other risks associated with our international operations. Any of these risks could harm our international operations and reduce our international sales, adversely affecting our business, results of operations, financial condition and growth prospects.

Our revenues, results of operations and cash flows are subject to fluctuations due to changes in foreign currency exchange rates, particularly changes in the Canadian dollar, Australian dollar, Euro, British Pound, Japanese Yen and Brazilian Real.

The volatility of exchange rates depends on many factors that we cannot forecast with reliable accuracy. Although we believe our operating activities act as a natural hedge for a substantial portion of our foreign currency exposure at the cash flow or operating income level because we typically collect revenues and incur costs in the currency in the location in which we provide our application, our contracts with our customers are long term in nature so it is difficult to predict if our operating activities will provide a natural hedge in the future. Changes in foreign currency exchange rates can affect our revenues or financial results due to transaction gains or losses related to revaluing certain current asset and liability balances that are denominated in currencies other than the functional currency of the entities in which they are recorded. Moreover, significant and unforeseen changes in foreign currency exchange rates may cause us to fail to achieve our stated projections for revenue and operating income, which could have an adverse effect on our stock price. We will continue to experience fluctuations in foreign currency exchange rates, which, if material, may harm our revenues or results of operations.

The nature of our business requires the application of complex revenue and expense recognition rules that require management to make estimates and assumptions. Additionally, the current legislative and regulatory environment affecting U.S. Generally Accepted Accounting Principles ("GAAP") is uncertain and significant changes in current principles could affect our financial statements going forward.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets, liabilities, equity, revenues and expenses that are not readily apparent from other sources.

While we believe that our financial statements have been prepared in accordance with accounting principles generally accepted in the United States, we cannot predict the impact of future changes to accounting principles or our accounting policies on our financial statements going forward. In addition, were we to change our critical accounting estimates, including the timing of recognition of license revenue and other revenue sources, our reported revenues and results of operations could be significantly impacted.

The accounting rules and regulations that we must comply with are complex. Recent actions and public comments from the Financial Accounting Standards Board (the "FASB") and the Securities and Exchange Commission have focused on the integrity of financial reporting. In addition, many companies' accounting policies are being subject to heightened scrutiny by regulators and the public. Further, the accounting rules and regulations are continually changing in ways that could materially impact our financial statements.

The FASB issued new accounting guidance on revenue recognition that becomes effective for us beginning August 1, 2018. The standard permits the use of either the retrospective or cumulative effect transition method. We have not yet selected a transition method. While we continue to evaluate the impact this guidance will have on our financial condition and results of operations, any change in how we recognize revenues can have a significant impact on our quarterly or annual financial results from operations. In order to reduce the risk of financial statement volatility, we will likely need to revise how we license and deliver our software to customers. If we are unsuccessful in adapting our business to the requirements of the new revenue standard, then we may experience greater volatility in our quarterly

and annual results, which may cause our stock price to decline. In addition to greater volatility, the application of this new standard may result in the exclusion of licensing revenues from contracts in effect prior to the adoption date, which, despite no change in associated cash flows, could have a material adverse effect on our recognized revenues and net income.

47

---

## Table of Contents

We incur increased costs as a result of operating as a public company, and our management is required to devote substantial time to compliance initiatives.

As a public company, we incur legal, accounting and other expenses that we did not incur as a private company. In addition, the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley Act”), as well as rules subsequently implemented by the Securities and Exchange Commission (“SEC”) and the New York Stock Exchange, impose additional requirements on public companies, including specific corporate governance practices. We are required to comply with Section 404 of the Sarbanes-Oxley Act and we have incurred costs to implement additional internal controls as well as to obtain an independent auditors report on our internal control over financial reporting. Additionally, the listing requirements of the New York Stock Exchange require that we satisfy numerous corporate governance requirements. Our management and other personnel will continue to devote a substantial amount of time to these compliance initiatives. Moreover, these rules and regulations increase our legal, accounting and financial compliance costs and make some activities more time-consuming and costly. These rules and regulations could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors, our board committees or as executive officers.

If we fail to maintain effective internal control over financial reporting in the future, the accuracy and timing of our financial reporting may be adversely affected.

Preparing our consolidated financial statements involves a number of complex manual and automated processes, which are dependent upon individual data input or review and require significant management judgment. One or more of these elements may result in errors that may not be detected and could result in a material misstatement of our consolidated financial statements. The Sarbanes-Oxley Act requires, among other things, that as a publicly-traded company we disclose whether our internal control over financial reporting and disclosure controls and procedures are effective.

If a material misstatement occurs in the future, we may fail to meet our future reporting obligations. For example, we may fail to file periodic reports in a timely manner or may need to restate our financial results, either of which may cause the price of our common stock to decline. Any failure of our internal controls could also adversely affect the results of the periodic management evaluations and annual independent registered public accounting firm attestation reports regarding the effectiveness of our internal control over financial reporting that are required under Section 404 of the Sarbanes-Oxley Act. Effective internal controls are necessary for us to produce reliable financial reports and are important to helping prevent financial fraud. Furthermore, any potential transition in enterprise resource planning or other major operational system could impact the timely generation of our financial statements. If we cannot provide reliable financial reports or prevent fraud, our business and results of operations could be harmed, investors could lose confidence in our reported financial information, and the trading price of our stock could drop significantly.

If tax laws change or we experience adverse outcomes resulting from examination of our income tax returns, it could adversely affect our results of operations.

We are subject to federal, state and local income taxes in the United States and in foreign jurisdictions. Our future effective tax rates and the value of our deferred tax assets could be adversely affected by changes in tax laws. In addition, we are subject to the examination of our income tax returns by the Internal Revenue Service and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from such examinations to determine the adequacy of our provision for income taxes. Significant judgment is required in determining our worldwide provision for income taxes. Although we believe we have made appropriate provisions for taxes in the jurisdictions in which we operate, changes in the tax laws or challenges from tax authorities under existing tax laws could adversely affect our business, financial condition and results of operations.

We may not be able to obtain capital when desired on favorable terms, if at all, or without dilution to our stockholders. We may need additional financing to execute on our current or future business strategies, including to develop new or enhance existing products and services, acquire businesses and technologies, or otherwise to respond to competitive pressures.

If we raise additional funds through the issuance of equity or convertible debt securities, the percentage ownership of our stockholders could be significantly diluted, and these newly-issued securities may have rights, preferences or privileges senior to those of existing stockholders. If we incur additional funds through debt financing, a substantial

portion of our operating cash flow may be dedicated to the payment of principal and interest on such indebtedness, thus limiting funds available for our business activities. We cannot assure you that additional financing will be available on terms favorable to us, or at all. If adequate funds are not available or are not available on acceptable terms, when we desire them, our ability to fund our operations, take advantage of unanticipated opportunities, develop or enhance our products and services, or otherwise respond to competitive pressures would be significantly limited. Any of these factors could harm our results of operations.

48

---

Table of Contents

Our business is subject to the risks of earthquakes, fire, floods and other natural catastrophic events, and to interruption by man-made problems such as computer viruses.

Our corporate headquarters and the majority of our operations are located in the San Francisco Bay Area, a region known for seismic activity. A significant natural disaster, such as an earthquake, tsunami, fire or a flood, could have a material adverse impact on our business, results of operations and financial condition. In addition, our servers are vulnerable to computer viruses, break-ins and similar disruptions from unauthorized tampering with our computer systems. To the extent that such disruptions result in delays or cancellations of customer orders, or the deployment of our products, our business, results of operations and financial condition would be adversely affected.

Our stock price may be volatile, which could result in securities class action litigation against us.

The market price of our common stock could be subject to wide fluctuations in response to, among other things, the risk factors described in this report, and other factors beyond our control, such as fluctuations in the valuation of companies perceived by investors to be comparable to us and research analyst coverage about our business.

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

In the past, many companies that have experienced volatility in the market price of their stock have been subject to securities class action litigation. We may become the target of this type of litigation in the future. Securities litigation against us could result in substantial costs and divert our management's attention from other business concerns, which could seriously harm our business.

We currently do not intend to pay dividends on our common stock and, consequently, your only opportunity to achieve a return on your investment is if the price of our common stock appreciates.

We currently do not plan to declare dividends on shares of our common stock in the foreseeable future. Consequently, the only opportunity to achieve a return on investment in our company will be if the market price of our common stock appreciates and shares are sold at a profit.

Certain provisions of our certificate of incorporation and bylaws and of Delaware law could prevent a takeover that stockholders consider favorable and could also reduce the market price of our stock.

Our amended and restated certificate of incorporation and our amended and restated bylaws contain provisions that could delay or prevent a merger, acquisition or other change in control that stockholders may consider favorable, including transactions in which stockholders might otherwise receive a premium for their shares. These provisions may also prevent or delay attempts by stockholders to replace or remove our current management or members of our board of directors. These provisions include:

• providing for a classified board of directors with staggered three-year terms, which could delay the ability of stockholders to change the membership of a majority of our board of directors;

• not providing for cumulative voting in the election of directors, which limits the ability of minority stockholders to elect director candidates;

• authorizing our board of directors to issue, without stockholder approval, preferred stock rights senior to those of common stock, which could be used to significantly dilute the ownership of a hostile acquirer;

• prohibiting stockholder action by written consent, which forces stockholder action to be taken at an annual or special meeting of our stockholders;

• limiting the persons who may call special meetings of stockholders, which could delay the ability of our stockholders to force consideration of a proposal or to take action, including the removal of directors; and

• requiring advance notification of stockholder nominations and proposals, which may discourage or deter a potential acquirer from conducting a solicitation of proxies to elect the acquirer's own slate of directors or otherwise attempting to obtain control of us.

The affirmative vote of the holders of at least 66 2/3% of our shares of capital stock entitled to vote is generally necessary to amend or repeal the above provisions that are contained in our amended and restated certificate of incorporation. Also, absent approval of our board of directors, our amended and restated bylaws may only be amended

or repealed by the affirmative vote of the holders of at least 50% of our shares of capital stock entitled to vote.

49

---



Table of Contents

In addition, we are subject to the provisions of Section 203 of the Delaware General Corporation Law. These provisions may prohibit large stockholders, in particular those owning 15% or more of our outstanding common stock, from engaging in certain business combinations without approval of substantially all of our stockholders for a certain period of time.

These and other provisions in our amended and restated certificate of incorporation, our amended and restated bylaws and under Delaware law could discourage potential takeover attempts, reduce the price that investors might be willing to pay for shares of our common stock in the future and result in the market price being lower than it would be without these provisions.

## ITEM 6. Exhibits

The exhibits listed below are filed or incorporated by reference as part of this Report.

Exhibit Number	Description	Incorporated by Reference From Form	Incorporated by Reference From Exhibit Number	Date Filed
3.1	Amended and Restated Certificate of Incorporation	10-Q	3.1	March 14, 2012
3.2	Amended and Restated Bylaws	8-K	3.1	January 22, 2013
4.1	Form of Common Stock certificate of the Registrant	S-1/A	4.1	January 9, 2012
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act	Filed herewith		
31.2	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act	Filed herewith		
32.1*	Certification of the Chief Executive Officer and the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act	Furnished herewith		
101.INS	XBRL Instance Document	Filed herewith		
101.SCH	XBRL Taxonomy Extension Schema Document	Filed herewith		
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	Filed herewith		
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	Filed herewith		
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	Filed herewith		
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	Filed herewith		

The certifications furnished in Exhibit 32.1 hereto are deemed to accompany this Quarterly Report on Form 10-Q and will not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended. Such \*certifications will not be deemed to be incorporated by reference into any filings under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except to the extent that the registrant specifically incorporates it by reference.



Table of Contents

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 hereunto duly authorized.

Date: March 1, 2016

GUIDEWIRE SOFTWARE, INC.

By: /s/ Richard Hart  
Richard Hart  
Chief Financial Officer  
(Principal Financial and Accounting Officer)